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- Resurgence Of The Property Tax p. 2

The state shift of financial pressures to local government may have a counterpart in shifts of federal responsibilities to states, bringing new ideas for state taxes to finance the shift.

- What Happens When Federal Policy Changes? p. 7

The big action in state tax policy remains provider taxes as states try to minimize the impact on general funds of growing health care costs.

- Health Care Update p. 10

All the shifts — federal to state/local, state to local, and state to health care providers — leave state and local finances in the worst shape in a decade, according to two new surveys.

- Fiscal Conditions Poor p. 12

If they were nations, most states would rank among the top 50 in the world. If companies, most would make the Fortune 500. A few local governments have larger budgets than many states.

- How Significant Are States? p. 16

Miscellany covers housing starts, interstate moves, initiative and referendum, legislative turnover, public opinion, and more. Technical notes detail sources and caveats, plus a special note on enrollment projections.

- Miscellany p. 18
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RESURGENCE OF THE PROPERTY TAX

Property Taxes Rising

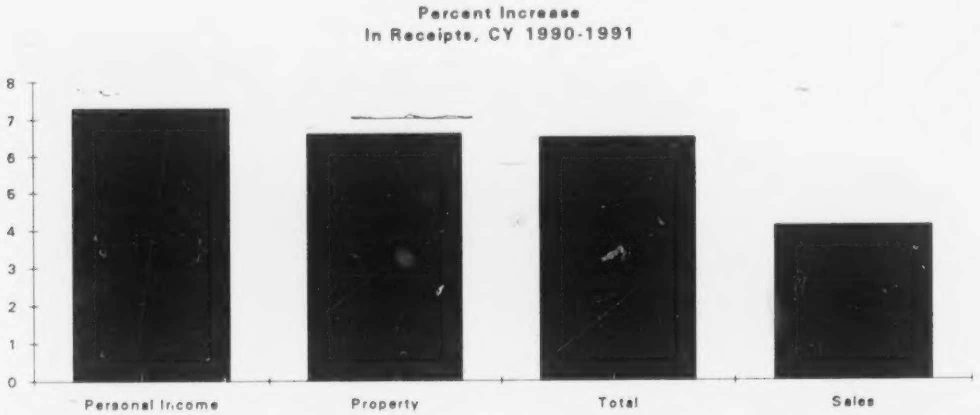
State and local reliance on property taxes and growing demands for services, particularly schools for baby-boomers, led to property taxes that took 4.77% of personal income in 1972. This large tax bite and public opinion polls indicating that voters like property taxes less than sales or income taxes led to many efforts to provide relief. They included sharply increased aid to local governments, particularly school districts, state-funded property tax relief measures, and tax limits such as Proposition 13 in **California**.

These policies and reduced pressure from school enrollments led to a reduction in property tax burdens to 3.27% of personal income in 1982. Many observers at the time saw the trend of lower reliance on property taxes as likely to continue. Legislators and governors, with few exceptions, committed themselves to relieve property tax burdens by a wide variety of measures.

The expected further decline in property tax reliance didn't happen. By 1990 (latest Census data) property taxes as a percentage of personal income had risen from the low of 3.27% in 1982 to 3.57%. The percentage will probably be even higher in 1991 and 1992. Property taxes have continued to rise with both rate increases and the delayed impact of increases in property values of the late 1980s. While property taxes rose, personal income growth was slowed by recession, tending to increase the percentage of personal income taken by property taxes.

The latest National Income Accounts data, shown on the chart, show property tax revenues in 1991 rising faster than either sales tax revenues or total state and local receipts. As the economy recovers, sales tax revenues should rise more rapidly than in 1991. Cost shifts to local governments associated with tight state budgets may also push property taxes higher.

Something, perhaps the contradiction between a commitment to reduce property tax reliance and actions that increase that reliance, caused several panels on property taxes to play to overflow audiences at the National Conference of State Legislatures (NCSL) meeting in late July. In one, Steven Gold (Center for the Study of the States) described the property tax trends, speculated on the factors causing them, analyzed how to control them, and concluded, "I have recently become convinced that states are going to shift more responsibility for raising taxes to local governments." He cited as examples **California**, **Maryland**, **Minnesota**, and **New York**.



Massive Differences Among States

The salience of property tax issues varies greatly among the states. By the representative tax system (States In Profile, Table D-21), sixteen states have property taxes that are 25% or more above the national average. Among the more populous states, these are #2 **Michigan** (57% above average), #3 **Iowa** (52%), #4 **Oregon** (52%), #5 **New York** (51%), #6 **Wisconsin** (47%), and #9 **New Jersey** (36%). Measuring property taxes as a percentage of personal income (Profile, Table D-9) propels some sparsely populated states (**Alaska**, **Wyoming**, **New Hampshire**, **Montana**, and **Vermont**) to the top in property tax burdens. By this measure, the larger states with the highest burdens are #5 **Oregon** (5.4% of income), #7 **New York** (4.8%), #8 **New Jersey** (4.8%), #10 **Michigan**, and #11 **Wisconsin** (4.6%).

By either measure, the lowest property taxes are found in the Southern states and Hawaii. About fifteen states have property tax burdens that are less than 80% of the national average, assessed by either measure of burdens.

The burdens of property taxes on particular types of property, such as residential and manufacturing, vary even more. Some states have constitutional uniformity provisions requiring that all property be taxed at uniform rates. Other states have classification systems that subject some classes of property (often commercial, industrial, and utility) to higher taxes than other classes (often residential and farm). Comparisons of burdens on particular types of property aren't available except for agricultural property. The table on the next page shows statewide average farm taxes. Only 27 states fall within the range of annual property taxes between 0.5% and 1% of the market value of farms. Farm taxes are particularly high in **Michigan**, **Wisconsin**, **Arizona**, and **New York**. Some Southern states have taxes that are less than a third of one percent of value.

Property Taxes On Farm Real Estate, Percent Of Market Value, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Michigan	3.30%	17	Massachusetts	0.71%	34	Wyoming	
2	Wisconsin	2.14	18	North Dakota	0.67	35	Tennessee	0.42
3	Arizona	2.10	19	Colorado	0.66	36	Utah	0.42
4	New York	1.96	20	Indiana	0.65	37	Maryland	0.41
5	Nebraska	1.35	21	Washington	0.64	38	Arkansas	0.40
6	Vermont	1.21	22	California	0.63	39	Missouri	0.37
7	Illinois	1.10	23	Montana	0.62	40	Oklahoma	0.37
8	Oregon	1.04	24	Connecticut	0.59	41	South Carolina	0.37
9	Iowa	0.99	25	Hawaii	0.59	42	Mississippi	0.29
10	Rhode Island	0.96	26	Florida	0.57	43	Kentucky	0.28
11	New Hampshire	0.94	27	Georgia	0.55	44	Louisiana	0.28
12	Pennsylvania	0.94	28	Kansas	0.55	45	Nevada	0.27
13	South Dakota	0.87	29	Maine	0.55	46	New Mexico	0.21
14	New Jersey	0.86	30	Texas	0.52	47	West Virginia	0.19
15	Minnesota	0.81	31	Idaho	0.51	48	Alabama	0.16
16	Ohio	0.78	32	North Carolina	0.48	49	Delaware	0.08
	United States	**0.78**	33	Virginia	0.47	50	Alaska	n.a.

These relative tax levels tend to be stable over time. Nationally, the percentage of value taken by property taxes on farms rose from 0.76% to 0.78% between 1989 and 1990. Taxes were higher in 34 states and lower in 13 states. Farm taxes are at about the level of the 1970s. They are up somewhat from the mid-1980s, but down somewhat from the 1960s.

Differing Approaches To Property Tax Reform

Sharp regional differences in reliance on property taxes and in property tax burdens have shaped attitudes about what constitutes property tax reform in individual states.

In high property tax states, reform means relieving pressures on the property taxpayer. The most comprehensive method has been the indirect attack that results from using state revenues to increase the percentage of school costs paid by states, reducing the percentage paid from local property taxes. Heavy use of local option sales and income taxes to finance cities and/or counties has also helped. Long-standing examples are **Ohio**, **Pennsylvania**, and **Tennessee**. More recently, county option sales taxes have been authorized in **South Carolina** and **Wisconsin.** Their use is spreading as counties in these states persuade voters to exercise the local option. To deal with remaining property tax burdens, the states with high property tax burdens have also invested heavily in the types of relief programs described in the next section.

In low property tax states, reform means *increasing* reliance on the property tax. Examples of recent changes or serious proposals for change include: (1) possible higher taxes on agricultural and timberlands (e.g., **Alabama** and **West Virginia**), (2) termination or restriction of large homestead exemptions (**Florida** and **Louisiana**), and (3) raising the local property tax effort in state school finance (**Georgia**, **New Mexico**, and **Texas**).

State Property Tax Relief Programs

Many states have adopted measures to reduce the burden of property taxes, such as homestead exemption and credits, circuit breakers, and deferral programs. A 21-page summary of these measures in each state was recently published by NCSL as State Property Tax Relief Programs For Homeowners And Renters.

State Property Tax Relief Under Attack

At the NCSL meeting N.J. Assemblyman Kamin (R) told legislators that "attitude adjustment time" had arrived, a time when legislators would need to recognize that state governments cannot afford large state-funded property tax relief programs. He reminded them of the giant **New Jersey** tax increase of 1990. It funded direct property tax relief in the form of checks of up to $500 per household. It funded indirect relief through large hikes in school aid for less affluent districts and special aid for fiscally pressed areas like Camden and Newark. The package proved extremely unpopular with voters, leading to a change from Democratic majorities to veto-proof Republican majorities in the elections of 1991. The new legislature, despite a worsening state fiscal posture resulting from recession, rolled back the sales tax by one cent. The largest single cut in spending was a sharp cutback of the property tax relief program.

Indirect support for the attack on the state property tax relief programs came from James Scherzinger (Oregon legislative fiscal staff) who reported that **Oregon**'s property tax relief and administrative reforms didn't deter voter approval of Measure 5, a property tax rollback approved by initiative.

The continuing discussions of trying to balance the **California** state budget show that programs supporting local government in the name of property tax relief are in trouble. In mid-July, Democratic legislative leaders met with city officials. House Speaker Brown told them that the state can no longer continue the subsidies begun in 1978 when Proposition 13 dramatically reduced property taxes. He told the unhappy local officials: "We need a response from you that's constructive. You have got to be helpful. Otherwise, the process is going to move in spite of your reticence." There is now serious discussion among majority legislators (D) of allowing higher local option sales taxes.

In **Massachusetts**, local governments continue to object to the state strategy for budget balancing. As Boston Mayor Flynn put it in late July, "Clearly, it is no exaggeration to say that state government fiscal stability is being purchased at the expense of local government services." He objected to cuts in local aid and to the governor's recent veto of legislation that would have eased the Proposition 2½ property tax limits. He argued that the state was cutting its taxes by putting fiscal pressure on local governments.

Unfunded State Property Tax Limits

The Oregon initiative provides for the state to offset losses in school funding resulting from the tax limits, but not all relief measures include this offset. In the same panel, Michigan Treasurer Douglas Roberts explained the governor's proposal for relief which was put on the November ballot by initiative. The "cut and cap" measure closely resembles California's Proposition 13 by capping increases in assessments on individual properties to the lesser of inflation or 3%. It also provides for a five-year phase-in of a 30% cut in school operating taxes. The state would reimburse the districts for the cut, but not for losses from the cap. There is no provision for increasing state revenues to cover the added state cost. Roberts estimated the FY 1994 state cost at $448 million, which would require nearly a 5% growth in revenues from existing taxes for this item alone.

A competing proposal by Michigan Democrats also limits property taxes, but fully funds the local government's loss with business tax increases. It failed to meet the signature requirement to go on the ballot. Over the last decade, Michigan leaders of both parties have favored plans to increase the sales tax and relieve property taxes for school finance. Proposals to do this need voter approval because the state constitution limits the sales tax to the current rate. The proposals haven't fared well with voters, getting 28% support in 1981, 28% in 1989 for a version with a half-cent sales tax increase and no guaranteed property tax cut and 24% for a two-cent increase with guaranteed property tax reduction.

Policy Prescriptions

At the conclusion of his presentation, Steven Gold suggested four state policies, all recommendations of NCSL's State-Local Task Force, to deal with local fiscal problems to help alleviate pressures on property tax revenues:

- Don't just reduce aid; target reductions based on needs and local fiscal capacities.
- Reconsider mandates and relax or repeal those that are no longer appropriate.

- In providing more revenue options for local governments, take steps to guard against fiscal disparities, such as by requiring that revenue be shared between places with large and small tax bases.
- Use state-financed tax credits to cushion the burden of regressive local taxes on low-and moderate-income households.

The other panelist (Hal Hovey, **Reports** editor) suggested that if substantial property taxes were to be permanent parts of state-local revenue structures, there were some politically viable steps legislators could take to minimize problems. His list:

- Clean up property tax administration by such measures as current value assessments.
- Adopt property tax deferrals (not exemptions) for the elderly and poor.
- Preserve the property tax base against proposed new exemptions.
- Spread large utility, commercial, and industrial property tax bases among local jurisdictions to avoid inequities, as **Michigan**, **Minnesota**, and **Mississippi** are doing.
- In making tax policy, consider state and local taxes together, as recommended in NCSL's Principles Of A High-Quality Revenue System.

Harry Green (Tennessee ACIR), who moderated the panel, emphasized concerns over erosion of the property tax base including: (1) preferential treatment of agricultural and open space land, (2) homestead exemptions, (3) exemptions for not-for-profit and governmental organizations, (4) economic development exemptions, (5) various exemptions and evasions affecting personal property such as computer software, and (6) federal preemption under the Railroad Revitalization And Regulatory Reform (4-R) legislation.

WHAT HAPPENS WHEN FEDERAL POLICY CHANGES?

The past five years have seen more stability in federal policy than has been seen since at least the 1960s. There have been no major changes in federal tax law since the 1986 tax reform legislation. Grant spending classified as entitlements, particularly AFDC and Medicaid, have had stable policy and funding. This has expanded with higher state spending as well as the impact of some cost-increasing mandates. Other grant spending has been subject to incremental revision, but massive new programs haven't been established and old ones haven't been abolished. For at least the past three years, the predictions of federal policy underlying state budgets have been right on the mark.

This situation could rapidly end. Any serious attempt to *reduce* the federal deficit would have an impact. A serious attempt to *eliminate* the deficit could have massive impacts, as suggested by the plan prepared for the Perot campaign for President. Proposals for restructuring of state and federal roles, typified by a new book by Alice Rivlin, are indicative of how federal-state fiscal roles might evolve.

Balancing The Federal Budget

Governor Clinton's and the President's proposals to reduce the deficit seem to bracket the likely changes. The changes are likely to be incremental, with little drastic effect on state budgets. Changes in federal taxes, such as the President's interest in lower capital gains rates and Clinton's interest in higher top bracket rates, would probably lead to some conforming changes at the state level, but states would have options in dealing with them. In spending, the impact outside of health care would likely be less generous funding of domestic discretionary programs, including reductions in grant programs.

National health insurance is the big unknown. Some of the plans would replace or substantially alter Medicaid. However, the plans are so expensive that they are unlikely to be vehicles for immediate state fiscal relief. Instead, they are designed to require continuation of some state funding for indigent care. The fiscal relief would appear as avoiding future state health care cost increases.

The Perot Prescription

The more interesting, but apparently remote, concern is what would happen if there were a determined effort to eliminate the federal deficit quickly. Such a scenario might be triggered by such a development as a collapse of international confidence in the dollar or accelerated inflation coupled with such high long-term interest rates that the housing industry and business investment appeared threatened. The leaked economic plan provided for the Perot campaign provides a basis for examining what might happen in such an event.

Most of the actions to control costs and/or increase revenues associated with Social Security and Medicare would have little impact on states except to the extent that states would be affected, like other employers, by increased employer taxes. The family of alternatives includes: (1) cutting the value of Social Security retirement benefits by such moves as: (a) phasing in a further increase in the retirement age, and/or (b) increasing the portion of benefits subject to tax in higher income households, such as the increase from 50% to 85% in the Perot plan, (2) cutting the net cost of Medicare by: (a) higher payroll taxes for Part A (hospital) coverage, including expanding the base of the current tax to the portion of income exceeding $130,000, (b) higher copayments for Part B (doctors and other) coverage, and/or (c) more extensive controls on utilization or provider reimbursement rates.

Many of the attacks on federal spending are likely to be outside the area of federal grants — including the defense budget, space exploration, and agricultural subsidies. The plans are likely to freeze most domestic discretionary spending, including grants, and perhaps impose percentage cuts like the 10% in the Perot plan. Individual grant programs, such as mass transit, may also be on hit lists. The candidates have also discussed higher spending on selected grant programs. Bush likes Head Start, preventive health, urban aid, and education. Clinton likes infrastructure, the environment, drug treatment, and Head Start.

The Perot and Clinton plans include higher personal income tax rates on high bracket taxpayers, a change with no direct impact on states. Perot's includes a tax on employer contributions to employee health care above a minimum level, a feature also found in many of the health finance proposals. This would increase the tax base for conforming states as well, as would other Perot proposals such as altered rules for transfer pricing and deductibility of entertainment expenses in the corporate tax law. Federal excise taxes — gasoline, tobacco, and/or alcoholic beverages — would also be on the increase list, though Clinton and Bush haven't been emphasizing them. A 50 cent hike was in the Perot plan. While having no technical effect on state taxes on the same commodities, sharp federal tax increases would depress demand and thus state tax revenues.

The Rivlin Recommendation

> *There were good historical reasons why power flowed toward Washington from the 1930s to the beginning of the 1980s. Similarly, there are now equally cogent reasons for reexamining the federal structure and dividing responsibilities more clearly between the states and the national government: revitalizing the economy and making government work better.*

With these words Alice Rivlin, first director of the Congressional Budget Office, concludes her new book Reviving the American Dream (Brookings, 1992). Rivlin attacks the "enormously confusing overlap of responsibilities" between state and federal governments. She argues that now is the right time to rethink the fundamental questions of federalism — which level of government should do what and how they pay for doing it.

Rivlin urges a more precise division of federal and state responsibilities. The federal government would concentrate on areas in which it is uniquely qualified, such as national defense and international relations, and leave most domestic policy to the states. They would accept a "productivity agenda", including education, job training, housing, transportation, and economic development. The federal government would "devolve" in these areas, dropping both funding and mandates. With the savings, the federal government would take responsibility for health care reform, including universal coverage. These offsetting federal costs and savings would still leave the budget unbalanced. Rivlin sees higher federal taxes as the only solution.

To cover their increased responsibilities, Rivlin believes the states would have to restructure their revenue systems. States would have to stop competing with each other on the basis of fiscal strength. She proposes "common shared taxes" as part of the solution -- a national sales tax or a value-added type of corporate tax which could be distributed among the states on some equitable basis such as population. States would also be encouraged to harmonize their tax treatment of corporate income to reduce administrative costs and to reduce inter-state competition. If health care is nationally available, then she says other social services could be administered state by state without large deviations in equity, particularly if all states had roughly equal per capita revenues through shared taxes.

The proposed restructuring resembles the "sorting out" proposals which intrigued many governors and the Reagan Administration in the early 1980s. The grand sorting out envisioned by the negotiations never took place, but federal grant funding has evolved to more emphasis on income-tested programs like AFDC and Medicaid relative to other grants. The idea of states harmonizing tax bases was reflected in the initial federal revenue sharing legislation. It offered states the option of piggybacking on the federal income tax, complete with use of the IRS to collect state taxes. No state, however, took advantage of the federal offer.

Rivlin's book is not a legislative agenda. There is no specific advice on how to implement the proposed changes, many of which would require federal action as well as coordinated actions by all 50 states. Reviving the American Dream is a useful framework for discussion. Although it will probably be read more in classrooms than in offices, its ideas are close enough to reality that Rivlin was scheduled as a key speaker at this summer's meeting of the National Association of State Budget Officers. National Governors' Association executive director Ray Scheppach reflected some of the same thinking in telling the press, as the NGA August meeting convened, that governors were increasingly taking over domestic programs. He commented that the federal government "is just too big to do it." He suggested that the federal government can provide some minimum standards and some financing, but "there is no way that they are going to be able to run these programs out of Washington."

HEALTH CARE UPDATE

Provider Taxes: At its annual meeting, NCSL gave the media an assessment of the impacts of the federal Medicaid Moratorium Amendments, based on the group's survey of states. There are 12 states that had donation programs disallowed under the legislation. Thirty states had some type of provider assessment "in place or pending prior to federal law changes." Of these, 28 will require significant changes. NCSL concludes, "The restrictions the federal government has placed on provider taxes will cause significant disruptions in state Medicaid programs and will guarantee Medicaid will remain one of the most pressing state budget issues for the next two to three years."

For many states, the first major compliance date under the new law is September 1. The federal implementing regulations haven't been published, so "states will essentially be on their own" in determining what constitutes compliance.

Many states have left themselves work to do on controversial Medicaid financing measures. For example, in signing the new provider tax measure in July, **Illinois** Governor Edgar commented, "We're not out of the woods on the issue of health care in this state." The measure raises over $700 million annually from providers and an equal amount in federal matching funds to help cover Medicaid costs running at about $4 billion. The new tax is 2.5% of hospital net revenues, $6.30 per bed-day in nursing homes, and 13% of gross receipts for facilities for the developmentally disabled. Opposition by some hospitals led to making the tax temporary, so renewal or replacement will be an issue next year. As in other states, health providers would prefer that general taxpayers pay the cost.

The Illinois plan has a feature to offset its increase in nursing home costs for families paying their own nursing home bills. The plan risks federal disallowance as an attempt to make a legal provider tax program affecting all patients into an illegal donations program, with effects concentrated on Medicaid-funded nursing home services. Other states — such as **Louisiana**, **Tennessee** and **West Virginia** — have features in their provider taxes that may lead to disallowance, depending on how the federal legislation is interpreted.

Public Hospitals: The trend to sever ties between state and local governments and public hospitals continued with the recent announcement of more autonomy for the New York City Health and Hospitals Corporation, the nation's largest public hospital system. Like the 11 hospitals that Louisiana recently shifted, the New York hospitals will be more fiscally autonomous, keeping their own profits and eating their own losses as encouragement for more businesslike operations. The New York system is highly dependent on public programs, getting 72% of revenues from Medicaid, nearly 12% from Medicare, and 7.4% from the city for both purchased services for city employees and subsidies for non-paying patients.

State-Subsidized Indigent Care Plans: Continuing fiscal problems in states that have been most aggressive in trying to expand health care availability to the uninsured are setting limits on those programs. **Hawaii**'s governor recently vetoed an extension to certain short-term workers. **Maine**'s limited program is likely to be a casualty in the governor's new budget. The second phase of Health Care for Montanans is in trouble, for reasons expressed by its coordinator:

> *I don't know how much health care reform we can do when there isn't even spending change for seed money to try anything. The programs will be hurt because there's no money to even get started on things with long-range benefits. The budget problem stifles people's imaginations.*

Oregon Plan Rejected: Oregon has adopted a plan to alter health care for the poor by: (1) expanding eligibility substantially while (2) controlling costs. This includes eliminating some current low-priority mandated Medicaid coverage, including institutional care where home health care would work, and some expensive treatments (e.g. transplants, late states of AIDS). Before implementation, the plan had to achieve a federal waiver of federal Medicaid requirements. That waiver was rejected by federal officials in early August, but the state was invited to go back to the drawing board to produce a new plan. Critics suggested the Administration was seeking to get the issue off its desk before elections without turning it down completely.

FISCAL CONDITIONS POOR

FY 1993 Budget Outlook

Introduction: The first summary of this year's state budget actions appeared in late July when NCSL released its preliminary version of State Budget And Tax Actions: 1992. The report is based on actions of 40 states, excluding some late-acting large states including **California**, **Illinois**, and **Michigan**. Their inclusion in the final version, promised for September, won't improve the national picture. The report's summary calls the state outlook "as clouded as that of the national economy." It concludes:

> *State finances are at a very low point. Slow employment growth in most states indicates that economic recovery will continue to be slow. States have tended to respond with budget cuts and have limited tax increases to a much lower level than in 1990 and 1991. As revenue forecasts show, state officials do not expect significant recovery in FY 1993....*
>
> *Like last year, the states have enacted austere budgets that could easily come unglued if the economy falters further, or if federal mandates or other external forces drive health and welfare spending beyond budgeted levels.*

Fiscal Strategy And Balances: FY 1992, which ended for most states in June, turned out to be one of the worst years in state financial history. Unexpected revenue shortfalls and higher-than-expected expenditures led to mid-year budget adjustments that, nationwide, proved inadequate to maintain balanced budgets. As a result, instead of increasing their balances to the 5% of spending that many states use as a target, balances eroded from 2.6% of spending at the beginning of the fiscal year to 1.4% at the end. Reported revenue growth was only 4.2% despite substantial tax increases enacted in 1991.

The national pattern in fiscal strategy was to avoid major tax increases and sharp spending cuts. As a result, only a slight recovery in balances, to 1.7% at the end of FY 1993, is reflected in the enacted budgets. The balances are highly concentrated in a few states with five states — **Alaska**, **Kansas**, **Indiana**, **Minnesota**, and **Oklahoma** — holding over half of the end-FY 1993 total.

Revenues — Slow Growth With Few Tax Increases

General fund revenue growth in FY 1992 was 4.2%. A revenue increase of 7.1% is expected for FY 1993, about 5.7% associated with normal economic growth and about 1.4% associated with tax increases. The tax increases are down substantially from the 5.4% reported for FY 1992. Two states reported major tax cuts. **New Jersey** rolled back a previous one-cent increase in the sales tax. **Pennsylvania** rolled back, as scheduled, some of the tax increases adopted in 1991. The largest tax increases were in **Iowa**, **Kansas**, and **Maryland**. Health care provider taxes accounted for 42% of the tax increases reported in the survey.

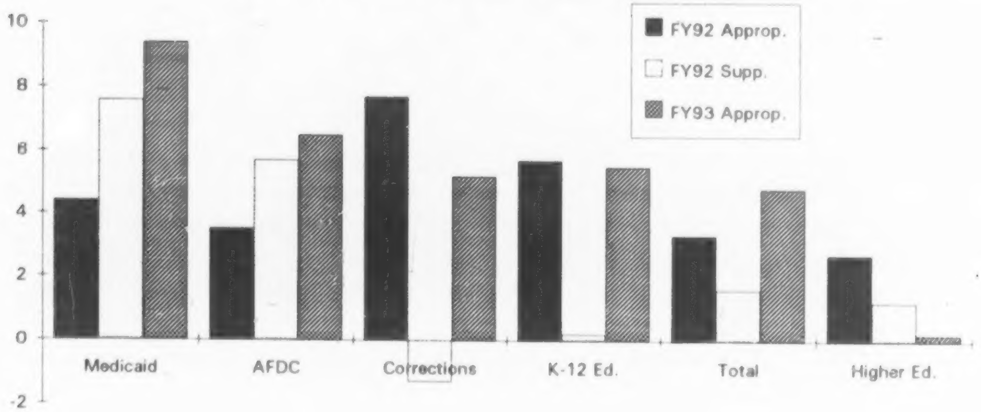
Spending Priorities And Risks Unchanged

The overall spending increase reflected in the enacted budgets was 4.8%, about the same as the actual increase in FY 1992. The FY 1993 number will probably grow with the enactment of supplemental appropriations later in the fiscal year.

The NCSL survey shows that FY 1993 budget increases are reflecting a familiar pattern, which is shown graphically on p. 14. The budgeted increases for the new fiscal year (shown in the third column for each program) are 4.8% for total general funds. Public school increases (5.5%) are above total budget increases (4.8%), as are the increases for Medicaid (9.4%), AFDC (6.5%), and corrections (5.2%). Higher education (0.2% increase) and all other programs (not shown) fared the worst.

Will actual spending increases correspond to what was approved in the FY 1993 budgets? Unlikely, if the experience of FY 1992 is repeated. During the year the original increase (first columns of the graph) were increased by supplemental appropriations to cover spending overruns (middle columns). These adjustments are minor in elementary and secondary education. They were negative for corrections, where appropriations for capital outlays often aren't entirely spent in one year. They were massive for AFDC and Medicaid. *In both these programs, more of the increased FY 1992 spending was appropriated in supplemental budgets than in regular budgets.* Put another way, by error or design (often both), state officials adopted budgets apparently giving larger increases to K-12 education than Medicaid and AFDC, then implemented budgets that did the reverse. This pattern could be repeated in FY 1993, driving up the costs of these programs and total state spending.

Percentage Growth By Spending Category
FY 1992 Budget and Supplementals, FY 1993 Budget



The Fiscal Outlook

Many of the enacted state budgets, **Reports** continues to believe, will be changed substantially before the fiscal year is over. Absent a striking improvement in national economic circumstances, some legislatures and many governors are likely to be making post-election budget adjustments to deal with: (1) higher-than-expected spending, particularly in Medicaid and AFDC, (2) Medicaid financing including provider taxes, and (3) major tax issues not concluded so far this year including school finance in **Texas**, dealing with Measure 5 in **Oregon**, and possible revival of major tax reform in **Alabama**, **Louisiana**, and **Tennessee**, and (4) patching fiscal solutions such as the one adopted in **Illinois**, and the one likely to be adopted in **California**.

Many of the state situations that are likely to require patching before the fiscal year is out aren't being discussed in the pre-election environment. One exception was Governor Edgar's comments on the **Illinois** budget, which he publicly characterized with phrases such as "out of whack," "fake cuts," and "smoke and mirrors." These concerns weren't seriously addressed by his vetoes, which affected only about 0.1% of the total. Why approve a bad budget? Edgar's answer was:

> *I feel I have no choice but to sign this budget because we are in the midst of an election year and we probably can't expect anything better than what we have.*

At the NCSL meeting, the organization's president-elect (Art Hamilton, minority (D) leader of the Arizona House) called the fiscal situation "ugly," but suggested that states could grow out of recession.

The NCSL survey suggests that state officials are generally assuming a steadily growing economy (about 3% real growth) in FY 1993. Slower recovery would exacerbate an already poor situation. Significantly faster growth or rapid inflation would bail out many states. Hamilton warned about the fiscal effects of additional federal mandates, suggesting "The battle cry of this conference should be 'No more mandates'."

In addition to the unknown factor of possible additional mandates, such as those that might be involved in federal action on health care, there are a significant number of previously enacted mandates which are gradually increasing their fiscal impact on state and local budgets. At the state level, the most significant ones are in Medicaid and social services. At the local level, the growing bites of federal drinking water and pollution control measures are increasingly becoming apparent.

A recent Stateside Associates poll of legislative leaders asked for the dominant issues in the legislative sessions this year. Budget/tax issues were mentioned by 88% of respondents, massively more than the next highest issues, health care (33%) and education (30%). Next year, the respondents expect budget and tax issues to have somewhat less importance (73%) and education to rise in importance (53%). Absent more good news on the nation's economy than has appeared so far, legislators may face another year of legislative sessions in which fiscal pressures tend to drive other issues far down on their agendas.

Local Governments Under Pressure

Although no reliable quantitative information is available, fiscal pressures on local governments in most states have clearly been increasing. A recent survey of cities shows declining balances and enactment of tax or fee increases by 72% of the responding city officials. Property tax rates were raised by 29% of the cities. Over half raised fees and charges while 29% adopted new fees.

The causes are well understood: (1) recession impacts on revenues and spending, (2) the translation of stagnation in real property values into assessed values, (3) cutbacks in state aid in some states, and (4) the continuing impact of shifts in federal spending toward state-oriented programs like AFDC and Medicaid and away from locally oriented programs like Community Development Block Grants and economic and community development programs generally.

HOW SIGNIFICANT ARE STATES?

Ranking States And Countries

California officials are fond of the line, "If California were a country, it would be ranked seventh among the economies in the world." For those who like such comparisons, the National Governors' Association recently issued a sheet that provides rankings using: (1) gross national product for countries, (2) gross state product for states, and (3) gross sales for corporations.

The less interesting comparison is between states and companies. Using gross state product for states means that 13 states are economically more significant than the top-ranked corporation (General Motors with sales of $126 billion). Over half the states outrank #5 company IBM. Every state ranks in the top 50 of the Fortune 500. State claims for size relative to corporations would be much more modest if revenues of state government, or state and local governments combined, were compared with company gross sales.

Comparing aggregate economic activity of states and nations provides interesting results for all states. Some examples from the NGA fact sheet are shown below. The table shows the state, the state's rank if it but no other state were ranked as a nation, the state's rank if all states were ranked as countries, the smallest country with a larger economy than the listed state, and the largest country with a smaller economy than the state.

Comparing Gross Products Of States And Countries, 1989

State	Rank*	Rank**	Just Below	Just Above
California	7	7	United Kingdom	Canada
New York	8	9	Canada	China
Texas	11	13	Spain	India
Illinois	12	15	India	Australia
Pennsylvania	14	18	Netherlands	Switzerland
Florida	14	19	Netherlands	Switzerland
Ohio	14	20	Netherlands	Switzerland
New Jersey	14	21	Netherlands	Switzerland
Michigan	17	25	Sweden	Mexico
Massachusetts	19	28	Belgium	Austria
Wisconsin	22	39	Denmark	Norway
Louisiana	26	47	South Africa	Turkey
Colorado	29	52	Poland	Thailand
Oklahoma	34	62	Algeria	Venezuela
Arkansas	41	74	Columbia	Malaysia
New Mexico	49	89	Hungary	Peru

* If state were a country, it would be the __ largest country in the world.

** If all states were countries, this state would be the __ largest in the world.

The new wrinkle in these comparisons is appearing in **California**. State officials and private observers have been comparing the state's $11 billion budget gap with other country economies and other state budgets (e.g., the gap is larger than the entire national product of X countries and larger than the total budgets of Y states.).

Ranking States And Companies

State governments also are impressively large when their revenues are compared with the revenues of large companies. A new compilation combines data for state general revenues and company sales (both FY 1990) showing that 26 states would, if they were companies, be ranked in the top 100 of the Fortune 500 companies. The table below follows the format of the previous one to show selected state rankings.

Comparing Gross Products Of States And Companies, 1990

State	Rank	Rank	Just Below	Just Above
California	4	4	Ford Motor	IBM
New York	7	8	General Electric	Philip Morris
Texas	14	16	Boeing	Shell Oil
Pennsylvania	16	19	Procter & Gamble	Occidental Petroleum
Illinois	18	22	United Technologies	Dow Chemical
Florida	18	23	United Technologies	Dow Chemical
Ohio	19	25	Dow Chemical	USX (U.S. Steel)
Michigan	19	26	Dow Chemical	USX (U.S. Steel)
New Jersey	23	31	Xerox	PepsiCo
Massachusetts	25	34	McDonnell Douglas	ConAgra
North Carolina	37	47	Allied-Signal	Sun (Oil)
Maryland	47	64	Bristol-Myers	Coca-Cola
Arizona	70	94	Honeywell	Am. Home Products
Mississippi	112	143	Dresser Industries	Johnson Controls
Rhode Island	181	221	National Steel	Sun Microsystems
South Dakota (smallest)	294	343	Hartmarx (cards)	American Greetings

Ranking States And Local Governments

The same technique can be used to intersperse local governments with state governments using revenues as the basis for comparison as shown on the table (next page). Only the local governments shown have revenues greater than the lowest state. Most of the local governments shown have multiple functions. The exceptions are the cities of Los Angeles, Chicago, and Detroit, and Los Angeles County. Philadelphia, San Francisco, Miami-Dade, and New York have both city and county functions. The District of Columbia handles city, county, and state functions.

Comparing Revenues Of States And Local Governments, 1990

Local Government	Rank	Rank	Just Below	Just Above
New York City	9	9	Michigan	New Jersey
Los Angeles County	33	34	Mississippi	Alaska
Los Angeles City	39	41	New Mexico	Hawaii
District of Columbia (city-state)	39	42	New Mexico	Hawaii
Chicago	43	47	Rhode Island	New Hampshire
Philadelphia	43	48	Rhode Island	Hawaii
San Francisco	48	54	Delaware	North Dakota
Dade County (Miami)	49	56	North Dakota	South Dakota
Detroit	50	58	South Dakota	Vermont

MISCELLANY

Housing Advances Unevenly

Housing statistics often provide a good indicator of state economic turnarounds because major upturns or downturns tend to be magnified in the housing market. This year is no exception, as suggested by the table.

Percentage Increase In Residential Building Permits
January-April 1991 To January-April 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Montana	93%	18	Illinois	33%	34	Rhode Island	16%
2	Wyoming	77	18	Missouri	33	34	West Virginia	16
3	Colorado	66	18	North Dakota	33	36	New Hampshire	14
4	Kentucky	51	21	Oklahoma	32	38	South Dakota	14
4	Louisiana	51	22	Indiana	30	38	Oregon	13
6	Idaho	50	22	Texas	30	39	Arkansas	11
7	New Jersey	47	24	Wisconsin	29	39	Pennsylvania	11
8	Mississippi	44	25	Connecticut	27	39	South Carolina	11
8	Utah	44	25	Massachusetts	27	42	Maine	8
10	Arizona	40	25	Washington	27	43	Vermont	7
11	Nebraska	38	28	Minnesota	23	44	New York	5
12	Kansas	37	28	Ohio	23	45	Florida	3
12	Maryland	37	30	Virginia	22	46	Delaware	1
14	North Carolina	36	31	Georgia	21	47	Alaska	-9
15	Alabama	34	31	New Mexico	21	48	California	-13
15	Iowa	34	33	Michigan	20	49	Nevada	-14
15	Tennessee	34		**United States**	**18**	50	Hawaii	-42

Nationally, starts were up by 18% in the first third of 1992 compared with a comparable period last year. Thirty states were within the range of a 36% to 0% increase. Three formerly rapid-growth states — **California**, **Hawaii**, and **Nevada** — showed dramatic declines. This has been reflected in their finances. California still doesn't have a budget because elected officials can't seem to solve a shortfall of $11 billion. Hawaii has a budget, after revising revenue estimates for FY 1992 downward to single digits and deciding that FY 1993 will see little growth. Nevada is making similar adjustments. The good news is the acceleration of already rapid growth in **Idaho** and **Utah** and revival in previously depressed mining-oriented economies of some states in the Far West.

Interstate Moves

The patterns of interstate moves recorded by a major van line provide a current indicator of the relative economic attractiveness of the states. The table ranks the states by the percentage of moves made by Allied Van Lines that were into each state.

Percentages of Allied Van Line Moves That Were Inbound, 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Oregon	66.9%	18	Florida	54.7%	34	Maryland	47.8%
2	Montana	66.0	19	Tennessee	54.6	35	Ohio	47.4
3	Nevada	63.5	20	Kentucky	54.3	36	Louisiana	46.9
4	Alaska	63.3	21	Mississippi	54.3	37	Delaware	45.1
5	Washington	62.7	22	Texas	53.1	38	Pennsylvania	44.9
6	Colorado	61.9	23	Kansas	52.9	39	South Dakota	44.9
7	Maine	61.9	24	Idaho	52.4	40	Wyoming	44.8
8	Georgia	60.9	25	West Virginia	52.3	41	Oklahoma	44.0
9	North Carolina	60.0	26	Minnesota	52.0	42	Illinois	43.4
10	Arizona	58.8	27	Wisconsin	50.6	43	California	42.5
11	Alabama	58.7	28	Indiana	50.3	44	Michigan	42.0
12	Vermont	58.2		**United States**	**50.1**	45	New Hampshire	41.3
13	South Carolina	57.4	29	Missouri	49.9	46	Massachusetts	40.5
14	New Mexico	57.0	30	Nebraska	49.8	47	New Jersey	39.5
15	Arkansas	55.7	31	Iowa	49.2	48	Connecticut	39.2
16	Hawaii	55.5	32	Rhode Island	48.8	49	New York	39.0
17	Utah	55.2	33	Virginia	48.1	50	North Dakota	35.4

The table shows familiar patterns: net migration into traditional retirement havens and rapidly growing states and outmigration from the Northeast and Midwest. But two New England states, **Maine** and **Vermont**, are among the leaders. The losers include Oil Patch states — **Louisiana Oklahoma**, and **Wyoming** — as well as states like **Massachusetts**, **New York**, and **Pennsylvania**. **California**, a traditional destination state, ranks 43rd.

Initiative And Referendum

Direct democracy procedures — initiative, referendum, and recall — are common in Western states (plus Massachusetts), but rare east of the Mississippi River. There has been little change in the past two decades. **New Jersey** was about the best prospect for adoption with its new veto-proof Republican majority in the legislature. Initiative is included in the party's platform and has been advocated by Republican legislators for a decade. It is also supported by Governor Florio (D) and by Hands Across New Jersey, the group that organized the state's tax revolt. But when the time came to put the constitutional amendment on the ballot by a late July vote, many Republicans defected to join the Democrats in opposition, so Garden State voters will not vote to decide what they can vote on.

Legislative Turnover

The record turnover of legislators this year was a major on-the-record topic and an even more significant hallway topic at the National Conference of State Legislatures meeting in July. NCSL staff expects the highest turnover since the 1960s, when the Supreme Court's "one-man, one-vote" decision caused massive shifts of representation from rural to urban areas. Contrasted with a usual turnover of about 20%, NCSL estimates that about 2,500 of 7,500 state legislators will be leaving office before considering whatever additional turnover is caused by voter decisions in the November elections. About 80% of all legislators are running this year. A survey of legislative leaders by Stateside Associates suggested 33% turnover nationwide.

The causes of the higher turnover aren't easily quantified. Reapportionment clearly accounts for some early retirement. Discussion of other causes concentrated on: (1) longer sessions and greater workload, (2) tougher formal and informal standards on conflicts of interest, inhibiting legislators from earning income beyond their legislative pay, (3) reaction to voter distrust of incumbents, and (4) inability to achieve constructive solutions because of fiscal constraints. No major changes in patterns of party control seem likely to result from the turnover, which seems to be affecting both parties in about the same way.

One result of turnover will be inexperience in influential positions. NCSL President Paul Burke (Kansas Senate President) said that the key committees in his state were likely to have freshmen as chairmen because nine major committee chairman weren't seeking reelection.

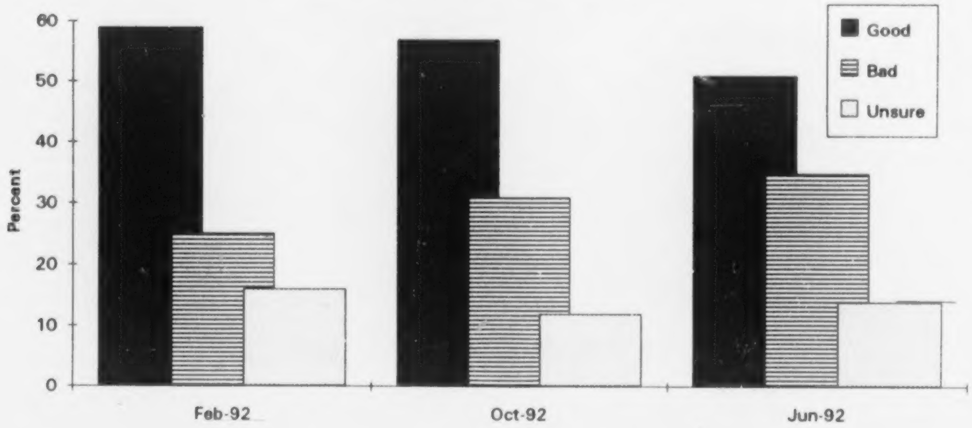
Public Approval of Gambling

A recent **Iowa** Poll by the Des Moines Register (7/12) suggests that enthusiasm for legalized gambling has waned slightly as the state experiences some setbacks.

Iowa's greyhound tracks are in financial difficulty. The only horse track closed three years after it opened. The first state to authorize riverboat gambling has competition from Illinois on the Mississippi River and possible competition from neighboring states considering riverboats on other rivers. Several Iowa-based boats have now shifted down river to Mississippi, which now permits them as well. Gambling operators are looking for ways to improve their finances, including reducing the restrictions and taxes on their operations.

The chart shows that a decreasing number of Hawkeyes, though still a majority, believe that legalized gambling has been good for the state.

Iowa Voters Answer
"Has legalized gambling been good or bad for Iowa?



Asked about specific forms of gambling, Iowa voters say they want all the current forms to remain legal. Support for continued legal status is highest for bingo (89%), followed by the lottery (81%), riverboat casinos (67%), horse racing (66%), and dog racing (66%).

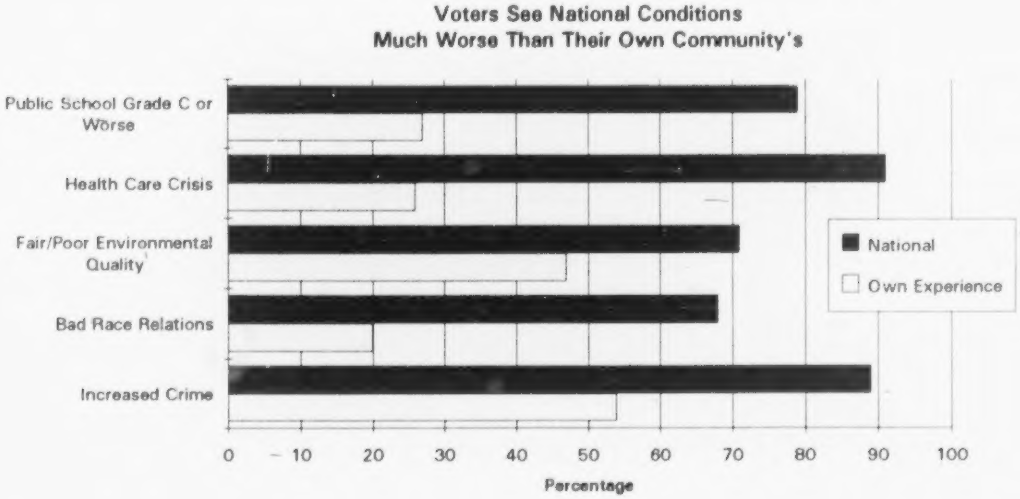
Gambling also has its critics among elected officials in states where it has been most successful. For example, in July, Governor Chiles and the **Florida** lottery director had a news conference to announce a new sales record of $2.2 billion in FY 1992. But Chiles called the lottery "a fraud on the public, the lottery employees, (and) the retailers," because proceeds weren't being used to buy extras in the schools, like computers and pre-school. Instead, he said, lottery dollars were replacing general fund money that otherwise would have been provided to schools, and thereby making possible increased spending for programs like Medicaid.

Chiles' remarks were rapidly picked up by opponents of the lottery measure on the November ballot in **Georgia**. Opponents are running adds portraying the lottery as a worm eating the educational apple. Governor Miller is spearheading the proponent's drive. He claims that Georgia has "learned from Florida's mistake" and that lottery money won't simply supplant other school funding.

Public Perceptions Of How Things Are Going

The public's perceptions of conditions in the United States do not appear to be based on personal observations. Polls consistently show Americans ranking Congress worse than their Congressman, legislators worse than their legislator, and economic conditions in the country worse than economic conditions in their household.

Polling data from differing sources reported in The American Enterprise (July/August) shows this perception difference applies to conditions like crime, the environment, and race relations as well.



The practical significance of the consistent difference in perceptions of voters' own situations and national situations could be debated. The difference probably has something to do with the consistent success of incumbents in seeking reelection despite widespread dissatisfaction with national and state situations shown in opinion polls.

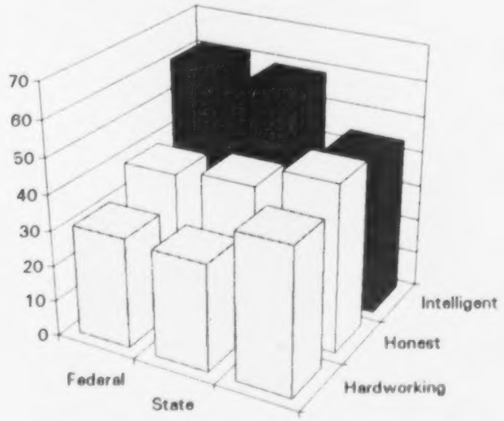
Vested Interests And State Voting

In his presentation at the NCSL meeting on property taxes, Michigan's treasurer included a calculation (which could be made for any state) which compares the number of persons with vested interest in state spending with the total number of people who voted in the last statewide election. It shows those with an interest constituting a majority of those voting assuming, which he concedes isn't true, that all those with a vested interest vote. Michigan has 715,000 state and local employees and retirees, almost 500,000 students at state higher educational institutions, and about 225,000 AFDC recipients.

Also Noted

More Junk Rankings: Value at zero or worse the state rankings (City & State, 7/13) that conclude that "New Jersey is the best of states and Nevada is the worst when it comes to protecting the environment." The magazine doesn't disclose how it made the rankings, doesn't even indicate how some states did, hasn't done well with its other rankings, and has results that don't seem to correspond to other measures.

Have Listed Characteristics, Illinois, 1991



Comparing Public Employees: Federal workers are more intelligent, but less likely to be honest or hardworking, than local and state workers according to 1991 survey (Illinois Issues, June). A sample of Illinois residents was asked if most, some, or just a few workers were hardworking, honest, and intelligent.

The results show states between federal and local. Responses on the level giving respondents the most for their money favored local governments (33%), over federal (29%) and state (28%).

Taxes By Any Other Name: Last year, **Texas** revised its net-worth-oriented franchise tax to include a calculation of liability based on income. This triggered continuing debate on whether the result is a corporate income tax or not. The distinction is important to Texans who like to say their state has no income taxes and who oppose a personal income tax. The state public utility commission entered the argument after permitting regulated utilities to pass along their extra taxes to consumers by specifying that the cost be separately stated on consumer bills as a "Corporate Income Tax Surcharge Approved by Texas Legislature." With a change in commission membership to a majority of Democrats, the entry will now read, "Cost of Service Surcharge."

Toll-Free In Virginia: This summer, tolls were eliminated on the **Virginia** section of Interstate 95 between Petersburg and Richmond and toll-taker jobs scrapped. The event runs counter to a trend to keep toll roads in operation to avoid adding their maintenance costs to state highway budgets, to make transfers to general funds by buying road segments (**New Jersey**), and arguably (in **Massachusetts**) simply to perpetuate self-finance authorities providing a bastion of power not easily controlled by state elected officials.

TECHNICAL NOTES

Property Taxes: The farm tax data come from the Department of Agriculture's Agricultural Resources: Agricultural Land Values And Markets (6/92).

Federal Impacts: The Perot plan was reported in U.S. News (8/3).

Fiscal Conditions: As usual, there are many caveats associated with national fiscal surveys. It is difficult to avoid shifting budget concepts from general funds to all funds particularly when gathering data on provider tax increases, which some states aren't treating as taxes, and in considering continuing current taxes, which NCSL counts as increasing taxes if a cut was scheduled (e.g., **New York**). The most recent report on city fiscal conditions was published in Nation's Cities Weekly (7/13). The annual report tends to show gloom and doom in good times and bad, but is particularly gloomy this year.

Legislative Turnover: Stateside Associates (2300 Clarendon Blvd., Arlington, VA 22201) is a state government relations consulting firm.

Comparing States And Companies: The comparison of states and companies, which **Reports** and the National Governors' Association have done from time to time, was done this year by The Governors Center At Duke University (Institute of Policy Sciences and Public Affairs, 4875 Duke Station, Durham, NC 27706) as The Fortune 500 And The 50 States. The local-state comparisons (from the obsolete 1987 Census of Governments), were done by the magazine City & State in its special publication City & State: 2000, published in early 1992. The NGA release is titled Comparison of States, Nations, and Corporations, 1989.

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IN THIS ISSUE

Corrections spending pressures are abating in some states, but not others. Different state choices on use of probation, parole, and early release programs explain many of the differences. The prevailing practice is to separate sentencing decisions from their cost consequences.

- Is The Corrections Crunch Ending? p. 2

As many states face tough fiscal choices in their FY 1994 budgets and some face shortfalls in the current year, there is new talk about structural imbalances. While experts debate whether this is a problem for states in the aggregate, it is clearly a problem in some states and not a problem in others.

- Built-In State Budget Deficits p. 9

There are conflicting signs of policy changes in seeking economic development, ranging from curtailing tax incentives in Alabama to continuing plant-by-plant, office-by-office competition for individual development projects. The latest job growth statistics show performance ranging from a 3% one-year gain in Idaho to a 3% loss in Connecticut.

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- Job Growth And Decline p. 18

Many states are adopting total quality management programs as part of reinventing state governments. Proponents are enthusiastic. Critics see another management fad.

- Total Quality Management p. 19

Miscellany covers late budget decisions and privatization. Technical notes detail sources and caveats.

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August 1992 (Second Of Two August Issues)

IS THE CORRECTIONS CRUNCH ENDING?

Signs Of Change? In the late 1980s, corrections joined with Medicaid as the programs putting the most strain on state budgets. The trend continued in FY 1991 when, according to the National Conference of State Legislatures' fiscal survey, corrections spending jumped 17.6% over FY 1990 levels. Two recent indicators suggest double digit growth in corrections spending may be ending.

NCSL's preliminary fiscal survey, released in July, noted that corrections spending in FY 1992 presented the "surprise" of falling below original budget levels. An increase of 7.7% was budgeted, but actual increases were an estimated 6.4%. This performance was in marked contrast to Medicaid, where budgeted increases of 4.4% turned into actual spending of 12% above FY 1991. The corrections increase budgeted for FY 1993 in the 40 states in the NCSL survey was 5.2%, barely above the 4.8% increase for total general fund spending. A second indicator of possible change was a slowdown in the growth of prison populations in California.

It is hard to tell what the future will bring. In making its long-term general fund forecast last fall, California's Commission on State Finance assumed that the Department of Corrections (CDC) forecasts of 5.3% annual increases in inmates and 6.3% increases in parolees would prove accurate. This would be slower growth than experienced during the 1980s. The Commission's comments are indicative of national uncertainty on this topic:

> *There are conflicting trends which could cause actual caseloads to be either higher or lower than the CDC forecasts.... They could be higher if the current lull in prison admissions merely reflects temporary administrative factors — such as changes in police practices or budget constraints of local criminal justice agencies — rather than more fundamental changes in social conditions.*
>
> *On the other hand, inmate population growth could be less than the CDC estimates if the recent declines represent more fundamental demographic and societal changes. For example, the male cohort group age 20-44 which accounts for nearly 90% of the institution population, is projected to increase at a slower rate in the 1990s than in the 1980s. Another argument for slowing growth is simply that incarceration rates are already at extremely high levels by historical standards, and, with an aging population, the rates seem unlikely to continue rising. Surveys also suggest that drug usage is down, indicating that, perhaps, drug arrests are also down.*

> *In summary, it is too early to tell with any certainty whether we are at a turning point with respect to inmate growth, or whether the recent lull is merely a temporary aberration in a continuing upward trend. Thus, the long-term outlook for spending on prisons is extremely uncertain.*

Prison Populations Continue To Grow: The growth of prison budgets is no mystery. Excluding capital outlays, prison budgets would be expected to grow by the combination of the national inflation rate (currently about 3%) and the percentage increase in the number of prisoners. The latest data on the increasing prison population shown below indicate national growth of 6.2%, which would make the expected corrections budget growth 9%. State corrections budgets don't grow at exactly the same rate as inflation plus prison counts. Growth can be slower if prisoners are crowded into existing facilities with existing guard staffing, but then shows sudden spurts as new institutions are opened.

At the end of 1991, there were 707,598 prisoners under the jurisdiction of state correctional authorities, an increase of 44,208 in one year. At a cost of $35,000 per prisoner year, the added cost of the 1991 increase in prison populations was $1.5 billion. At $50,000 per bed, the capital outlays to accommodate the increase would be another $2.2 billion.

Percentage Increase In Prison Population, 1990-1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Rhode Island	15.9%	18	Maryland	8.1%	34	California	4.6%
2	Washington	14.5	19	Delaware	7.2	35	Connecticut	4.5
3	New Hampshire	14.2	20	Alabama	7.0	36	Iowa	4.5
4	Arkansas	13.9	21	Wisconsin	6.9	37	Nebraska	4.3
5	Idaho	12.7	22	Vermont	6.7	38	Oregon	4.1
6	Ohio	12.3	23	Virginia	6.6	39	Alaska	3.7
7	New Jersey	11.1	24	Maine	6.4	40	Montana	3.7
8	Tennessee	10.7	25	Michigan	6.3	41	Texas	3.3
9	Nevada	10.5		**United States**	**6.2**	42	Missouri	3.1
10	Louisiana	10.0	26	Hawaii	6.1	43	North Carolina	2.7
11	Massachusetts	9.5	27	Georgia	5.8	44	South Dakota	2.5
12	Minnesota	9.3	28	Illinois	5.8	45	Kansas	2.2
13	Oklahoma	8.9	29	South Carolina	5.7	46	Indiana	2.1
14	Colorado	8.8	30	New York	5.4	47	North Dakota	1.9
15	Kentucky	8.6	31	Utah	5.1	48	New Mexico	-2.1
16	Mississippi	8.3	32	Pennsylvania	4.9	49	West Virginia	-4.0
17	Arizona	8.1	33	Florida	4.8	50	Wyoming	-5.0

The wide range of these one-year changes shows state policy decisions at work. This is most obvious when states are compared with their neighbors, presumably subject to the same trends in crime and economic circumstances that might affect both the propensity to commit crime and the willingness to expand prison space. For example, **Ohio** increased its prison population by 12.3% while **Michigan** lived with 6.3%, about the national average, and **Indiana** held the increase to 2.1%. In New England, **Connecticut**'s increase was a below-average 4.5% and **Vermont** was at about the national average, but **New Hampshire** and **Rhode Island** showed increases above 14%. These differences are related to policy choices such as sentence length, use of probation as an alternative to incarceration, early release programs, time off for good behavior, and use of parole.

Impacts Of Growth: The implications of rapid inmate growth have been striking in **Washington**, which was second highest in prisoner growth in 1991. Prisons are now operating at 165% of design capacity. Prison population went above 10,000 in June. It is expected to rise above 14,000 sometime in 1996. A legal services group has sued the state seeking relief from crowded conditions. Construction of six new prisons was started last year. The corrections agency received an extra $10 million in its FY 1992 budget to accelerate opening these facilities and recently received $15 million in emergency funding.

This situation is a major turnaround. Five years ago, Washington was renting prison space to other states and was offered as a national model for controlling the growth of inmate populations. The Corrections Secretary suggests the choices are building yet more prisons or policy changes: "We really need to decide who we need to put in prison and for how long." He cites as an example a cocaine-addicted mother of six with no prior offenses convicted of a minor drug offense. She was sentenced to 27 months in prison, which he suggests may not be an appropriate use of state prison space.

Florida's corrections system has held its increase in inmates below the national average only by entering a spiral of problems so severe that they have received national attention (e.g., Newsweek, 5/18). Its financial constraints limit new construction, which doesn't matter in the short-term because operating budget constraints have prevented opening facilities already completed. A consent decree limits putting more prisoners into existing space. So Florida uses early release to make room for new prisoners. As a result, the typical prisoner sentenced for one year actually serves only three months.

Recognition of the short times actually served caused legislative reaction, so there are more mandatory sentences. Prosecutors reacted with greater use of habitual offender laws with mandatory sentences. As a result, the group not eligible for early release went from 15% of prisoners in the fall of 1990 to 40% in the spring of 1992. With the need for early release growing and the number of prisoners who can be released early decreasing, the average number of days taken off sentences rose from 70 days in March of 1991 to 295 days in February of 1992.

Incarceration Rates: Differing policies, rather than differing crime rates, are the best explanation for extraordinary differences in the ratio of prisoners to population. Those differences are particularly striking among nations. Counting prisoners held by all levels of government, the U.S. imprisons about 0.45% of its population, higher than any other industrial nation. Selected other nations in declining order: South Africa (0.31%), Canada (0.11%), United Kingdom (0.10%), France (0.08%), and Japan (0.04%). The state rates (excluding local jail inmates) are shown below as the incarceration rate, prisoners per 100,000 population.

Incarceration Rates, 1991

Rank	State	Rate	Rank	State	Rate	Rank	State	Rate
1	Nevada	477		**United States**	**310**	34	New Mexico	191
2	South Carolina	473	18	New Jersey	300	35	South Dakota	190
3	Louisiana	466	19	Texas	297	36	Washington	183
4	Oklahoma	414	20	Virginia	297	37	Montana	182
5	Arizona	398	21	Missouri	294	38	Hawaii	172
6	Alabama	392	22	North Carolina	270	39	Rhode Island	172
7	Michigan	387	23	Connecticut	262	40	Wisconsin	158
8	Maryland	366	24	Kentucky	261	41	Massachusetts	150
9	Florida	346	25	Colorado	247	42	Utah	149
10	Alaska	344	26	Illinois	246	43	Nebraska	146
11	Delaware	342	27	Kansas	230	44	Iowa	144
12	Georgia	342	28	Oregon	229	45	New Hampshire	132
13	Mississippi	335	29	Tennessee	227	46	Maine	127
14	Ohio	323	30	Indiana	226	47	Vermont	125
15	California	320	31	Wyoming	225	48	West Virginia	82
16	New York	319	32	Idaho	212	49	Minnesota	78
17	Arkansas	314	33	Pennsylvania	192	50	North Dakota	68

There are explanations for differences in the state rates. Crimes are primarily committed by those aged 18-35. But the denominator in the incarceration rate is total population. So states with low ratios of age 18-35 population to total population — like **North Dakota**, **Pennsylvania**, and **West Virginia** — tend to have low incarceration rates. Crime is also an urban phenomenon, with rural states tending to export their crime-prone youth. Criminals are locked up by the states whose laws they offend. The incarceration rate measures prisoners where they are held, not where they grew up. So states like **Maine**, **Vermont**, and **South Dakota** would be expected to have lower incarceration rates than states like **Massachusetts** and **New York**. Substantial tourism swells the ranks of potential victims and criminals without affecting the population denominator, so higher incarceration rates would be expected in **Florida** and **Nevada** than the industrial Midwest.

All this being said, there is substantial unexplained variation that can only be attributed to significant state policies. First, there is a systematic regional variation with Southeastern states showing incarceration rates well above the national average. Second, there is variation within regions. For example **North Carolina**'s rate is below the national average while **South Carolina** is second only to **Nevada**. The rate for seventh-ranked **Michigan** (387) is well above that of neighbors **Ohio** (#14 at 323), **Indiana** (#30 at 226), and **Wisconsin** (#40 at 158). The **North Dakota** rate is less than half of **South Dakota**.

These comparisons are easily translated into their financial implications. For example, by lowering its incarceration rate to the U.S. average, **South Carolina** could eliminate roughly 35% of its corrections operating budget and experience the nationwide growth in inmates for eight years without adding any new prison capacity.

Parole And Probation Increases: Probation (an alternative to prison sentences) and parole (release before the end of a sentence) are the primary mechanisms for retarding the flow of new prisoners and discharging prisoners faster. In 1990, only 14% of those leaving state prisons were released unconditionally as their sentences expired. The rest were released on fixed schedules with post-release supervision or, in the case of about 40% of releases, given parole at the discretion of parole agencies. While they are cost-saving in relation to prisons, probation and parole have substantial costs for supervision and reporting. The growth in these programs has been even faster than the growth of prison populations. From 1989 to 1990 (latest data) there was a 7% increase in the number of people under some form of correctional supervision — prisons, jails, probation, parole, and other programs. More than 3% of the nation's adult males are on probation or parole.

The variations among states are even more substantial for these programs than for persons in prison. The table (next page) shows for selected states: (1) the percentage change from 1989 to 1990 in the number of persons on probation and parole and (2) number of adults in each form of correctional supervision for every 100,000 adult residents, as of 1990.

Even though they deal with only a single year, these statistics show how state policies differ. **Rhode Island** and **Connecticut** are trying to avoid parole. Their parole rates are 80% below the national average and they cut the number of people on parole in 1990. Perhaps in reaction to treatment of prisoner release issues in the 1988 Presidential campaign, **Massachusetts** avoided the parole increase that would be expected to be associated with a larger prison population eligible for parole and dramatically reduced probation. The policies of Rhode Island were exactly reversed in **Oklahoma** which de-emphasized probation but sharply increased the use of parole, though still maintaining a parolee-population ratio of less than half the national average. In **Georgia**, the number of people on both probation and parole is about twice the national average, but in **Kentucky**, both are less than half the average.

Statistics on Probation And Parole, Selected States

	Percent Increase, 1989-90		Rate Per 100,000	
State	Probation	Parole	Probation	Parole
United States	**5.9%**	**16.3%**	**1,443**	**287**
Massachusetts	-18.2	0.7	1,544	101
Delaware	26.0	26.7	2,430	255
Kentucky	-7.2	1.6	274	117
Georgia	7.7	29.9	2,838	477
Rhode Island	25.6	-18.3	1,975	41
Oklahoma	0.7	62.4	1,057	140
Connecticut	8.9	-9.6	1,838	11
Texas	5.9	20.2	2,538	903
California	7.5	17.5	1,389	307
New York	6.3	16.1	1,058	312
Illinois	1.9	21.5	1,128	208

Comparing Budget Increases: These striking comparisons of incarceration rates find little use in the politics of budgeting for corrections and even less in the cost-driving state decisions, like those on sentencing. They don't enter the state budget process at all. Instead, corrections policies enter the budget process on the politically sensitive point of comparisons with budget increases for education and other state functions. Two programs legislators don't point to with pride, corrections and Medicaid, have been achieving larger increases than other state programs, including education, for years. Part of the differential has been obscured for the public, and legislators themselves, by consistent underestimating of costs in these two programs. Much of the spending increases take the form of little-noticed supplemental appropriations.

This pattern has gone on for so long that it is now relatively well noticed by key legislators and interest groups. That factor and new tightness in state fiscal circumstances have motivated budget-oriented elected officials to take an increasing interest in controlling corrections costs, and thus examining what is driving incarceration rates and what, if anything, should be done about it.

Zero Defects And Willie Horton: There is no known way to prevent serious crime by accused felons awaiting trial but not in jail, by persons given a sentence of probation rather than prison time, by prisoners on work-release, and by former prisoners whose sentences have been shortened by good time or parole. Every one of these policies inherently carries the probability that innocent citizens will be murdered, robbed, and raped by persons who "should be in jail." The media coverage of these crimes need only report the event, the fact that the perpetrator "should be in jail or prison," and the outrage of the victim or victim's loved ones to set the stage for cries to end the programs and for later embarrassment of every state elected official associated with them.

This is often called the "Willie Horton factor" because of the use of one such incident in Massachusetts as an indictment of Governor Dukakis in the 1988 Presidential campaign.

> *These programs are clearly the right thing to do, no question. But I want to know what it will take to sell these programs because they might leave you open to political pot shots from people who would say you're soft on crime. I'm up for re-election this year, and Willie Horton is as well known in Rhode Island as is Michael Dukakis.* — Governor Sundlun quoted in the New York Times 8/7).

There are Willie Horton counterparts throughout the nation. For example, in **New Jersey** the new electronic surveillance procedure has about 633 participating inmates. They experienced a murder in April, followed by a beating and stabbing in May, followed by charges against a program participant for selling heroin from the apartment to which he was confined. The state senator in whose district the violence occurred called for suspension of the program. The Senate Law and Public Safety Committee held well-publicized hearings. The Corrections Department has put a planned expansion of the program on hold.

California legislators still talk about a 1980 victory by a 29-year-old unknown who upset a 22-year legislative veteran. He used a media campaign focusing on the incumbent's refusal to vote for increased penalties for repeat sex offenders like the East Area Rapist, who was never caught but was said to be responsible for 30 rapes in the district.

Varying Pressures For More Prisoners: The causes of increasing prison populations vary substantially among states, with an undercurrent of common reasons such as prison terms for drunk drivers. Part of the **Delaware** increase is associated with stiff sentences for first time drug offenders and a stricter definition of what constitutes a drug offense. Part of the problem in **Kansas** is a new parole board less willing to grant paroles. In **Massachusetts**, Governor Weld, a former prosecutor, has pushed for less leniency in the release of prisoners.

Crime Not Increasing

Since 1975, the Department of Justice has used surveys of households (the National Crime Victimization Survey) to determine how prevalent crime has become. The latest results show about 24% of U.S. households were victimized by crime in 1991, about the same as in 1990 and well below the 1975 rate of 32%. Considering only "crimes of high concern" (burglaries and violent crimes by strangers but not auto theft or crimes against other family members), the percentage of households affected dropped from 11% in 1981 to 7% in 1989 and has remained steady since.

The Outlook: The outcome of the current corrections controversies isn't easily predicted. Critics of high incarceration rates and ballooning corrections costs claim that states "can't build their way out of" the crowding of correctional institutions. Proponents of tougher sentencing either don't see the cost implications — and their implications for education, police protection, and other spending that might reduce crime — or take the view that corrections budgets should be whatever it takes to keep criminals off the streets.

Elected officials are looking for ways to satisfy both groups. This often leads to comments like one from Georgia's governor (City & State, 3/9): "We've got to have space available for major offenders, but we also realize that we cannot build our way out of our overcrowding crisis." It also leads to studies and task forces, such as one appointed by **Illinois**' governor this spring "to find innovative, cost-effective alternatives to building one prison after another."

One development may help relieve some of the current cost pressures. Court orders govern some prisons in 35-45 states, depending on who counts what. These are primarily consent decrees through which states have agreed to be subjected to court orders, and not the results of states losing litigation. Officials of some states appear to be taking a stronger stance against agreeing to such decrees. In January, the U.S. Justice Department — which has been a force in pushing such decrees in **California**, **Texas**, and other states — announced it would discontinue the policy except in extreme cases. The federal government, which runs prisons at 165% of capacity, will stop trying to enforce prison population limits on states, which overall operate at about 115% of capacity.

BUILT-IN STATE BUDGET DEFICITS

Are State Budgets Structurally Unbalanced?

Steven Gold (Director of the Center for the Study of the States) and Hal Hovey (**Reports** editor) have recently appeared together before several audiences discussing whether states face long-term structural deficits. This discussion is finding its way into secondary coverage, such as a lead article in City & State (8/10). If state structural deficits exist, important conclusions follow. First, by definition, current services (including adjustments for inflation and changes in workload such as the number of school children) cannot be maintained with taxes at current levels. Second, those who seek to maintain current services and particularly those seeking major cost-increasing initiatives (e.g., school finance equalization) should be backing ways to raise state revenues. Third, and conversely, those committed to holding the line on state taxes need to curtail current services. Fourth, because tax increases are never certain, those dependent on state funding can expect considerable uncertainty.

Minimum Conditions For Structural Balance

Gold and Hovey, along with most state officials, agree that state budgets in the aggregate will be out of balance unless two important conditions are fulfilled. First, the economy must show average annual growth in real gross domestic product of 2% or better, about the level being forecast for the 1990s. This is a somewhat slower growth rate than that of the 1980s for several reasons. The most important is an expected decline in the rate at which the number of American workers has been growing. In addition to demographic changes, the influx of women into the workforce has been going on for so long that future increases in labor force participation will be smaller than past ones.

Second, federal policy would need to: (1) avoid extensive new mandates and (2) continue current policy in grant programs. This includes inflation-matching growth in most programs and current matching ratios, without funding caps, in entitlement programs such as Food Stamps, AFDC, and Medicaid. There are many reasons to worry about federal policy in both areas. New mandates continue to be attractive to federal officials unable to stimulate state and local activity by new grant money. The new disability legislation, which is already the official federal reason for rejecting Oregon's health care initiative, is an example. Phased implementation of past mandates saved immediate fiscal impacts on state and local government, but means that mandates in pure drinking water, secondary and tertiary sewage treatment, and Medicaid coverage of young children, among others, have fiscal impacts yet to be felt. Current federal grant policy is clearly at risk from any serious attempt to balance the federal budget.

What Determines Structural Balance?

Assessing structural balance involves forecasting the relevant underlying economic and demographic trends. From these projections, revenues from existing sources at current rates and spending for current programs can be estimated and compared.

Revenues are usually related to personal income, with the basic relationships reasonably well known. Sales tax revenues will lag personal income growth because an increasing percentage of personal income is being spent on non-taxed services. Personal income tax revenues will grow faster than income because exemptions and deductions tend to be flat dollar amounts and many taxes have graduated rates. Over time, property taxes should rise with personal income as inflation affects both property and income in about the same way and population growth raises the stock of buildings as well as the number of workers. Excise taxes on volumes of cigarettes, alcoholic beverages, gasoline and other commodities and fixed fees for licenses will tend to lag inflation. When all this is added up, there is room for some difference of opinion, but state revenues probably tend to grow at about the same rate as personal income.

State and local government revenue growth may approximate personal income growth as well, particularly if assumptions about revenue include the concept that local fees — for garbage collection, water supply, sewage treatment, and other municipal utility charges — will reflect inflation.

Spending is subject to demographic trends. Some of these, such as the increasing number of elderly persons likely to seek nursing home care under Medicaid, are clearly unfavorable to state finances. The single most important demographic variable, the number of children at ages of school attendance, should be easy to predict as most of the children to be in school in the 1990s are already born. That trend is favorable to neutral. Enrollment growth of 1% or so means that the growth in the number of taxpaying workers will exceed the number of tax-consuming students, but by a lesser margin than in the 1980s.

"Technology," broadly defined, has mixed effects. Some technology, such as improved productivity of office machines, should have a favorable impact on government costs just as on private costs. Improved technology can increase health care costs, but also has had favorable impacts, such as reducing the costs of inpatient mental health care.

Structural Deficits And Policy Choices

Structural deficit projections implicitly contain definitions of policy choices. For example, the rising costs of public schools in the 1980s was heavily influenced by two trends: (1) a reduction in average class sizes, (2) extension of years spent in public school by (a) more widespread use of kindergarten, shifts to all-day kindergarten, and increased pre-kindergarten programs and (b) longer time in school by reducing dropout rates in the early years of secondary school. Costs of public schools have also been increased by defining an increasing number of students as requiring specialized services, particularly special education, with smaller class sizes. Depending on who does the projections, some continuation of these choices may be defined as part of state structural deficits.

In higher education, the dependence of costs on policy is even more direct. More students are attending college and staying there longer, with 4.5 years now the norm for undergraduate degrees. Higher education enrollment is clearly sensitive to state decisions, particularly those on scholarships, loans, tuition waivers, and tuition levels. By the same token, prison population change is a function of public policy on length of sentence, probation and other policies affecting the rate of admission to prisons, and work release, parole, and good time, affecting the rate of exit from prisons. While there is dispute over how large the effects may be, the welfare population is not independent of the level of welfare payments, the existence of work requirements, and job training programs. Medicaid participation is influenced by welfare eligibility requirements and state decisions on the services covered, as well as hard-to-measure differences in the ease of getting on Medicaid rolls.

Structural Deficit And Policy In California

Because the magnitudes of proposed changes are so large, the budget debate in **California** provides an unusual glimpse into the sensitivity of spending projections to policy choices. Already, the state has moved from a no-tuition policy for higher education to significant charges, still called fees. Further movement in this direction appears likely in the FY 1993 budget. It is already reflected in university plans even before a final budget is adopted. The impacts on enrollments are likely to be substantial -- discouraging attendance at residential universities relative to community colleges, discouraging part-time students with no degree objectives, and probably increasing percentages of students who choose private institutions for both vocational training and university work. Higher tuition may also cause students to complete fewer years than they would in a lower tuition environment.

There also is general agreement that California's welfare payment levels will be less generous than in the past and that work requirements will be strengthened. The governor has a proposal to alter enrollment in public schools by changing the age of admission to kindergarten. On the revenue side, Democrats in the legislature have been pushing a proposal to end the indexing of the personal income tax for inflation, a move that would significantly increase the change in receipts relative to the change in taxable income.

Structural Deficits In Individual States

The attempts to calculate current service balances, whether deficit or surplus, for states in the aggregate conceal the fact that few states have a nationally average combination of revenue structures, demographic trends affecting spending, and fiscal legacies.

> **Revenue structures that automatically cause revenues to rise faster than personal income help avoid structural deficits.** Examples are graduated income taxes without indexing, property taxes with non-indexed homestead exemptions, sales taxes that capture a large portion of growing service business, income taxes that capture Social Security and pension benefits, and excise taxes and fees indexed for inflation. **Hawaii** and **Minnesota** have such tax systems. States with no personal income tax, sales taxes without much coverage of services, non-indexed excise taxes and fees, and high reliance on severance taxes tend to have structural deficits. Examples are **Florida**, **Nevada**, **New Hampshire**, and **Texas.**
>
> **Demographic trends involving little or no growth in school age populations are favorable to avoiding structural deficits.** Nearly all the states in the Northeast and Midwest are examples. Conversely, Southeastern and Western states, particularly **Utah**, face rapidly growing enrollments.

The worst examples are **California** and **Florida**, where this year's budget issues have centered on whether to increase school aid enough to cover the combination of inflation and enrollment growth. Florida did not provide such an increase, despite a tax increase. California's budget delay is largely attributable to a determination to provide roughly this level of increase (which is mandated by Proposition 98) *and* avoid a tax increase.

Fiscal legacies are the impacts of past fiscal practices on current and future spending. Taxpayers of some states face negative legacies associated with high debt (e.g., **New York**) and underfunded pension plans (e.g., **Massachusetts** and **West Virginia**). With traditions of no short term borrowing, pay-as-you-go financing of capital outlays, and well-funded pension plans, Southeastern and Midwestern farm states tend to be in much better shape. States like **Texas**, **Wyoming**, and particularly **Alaska** have vast reserves in permanent funds.

Commitments, Court Orders, And Structural Imbalances

Structural imbalances are defined locally by differing ground rules. The most significant differences between individual state practices and the current service definitions used in national studies concern inflation, commitments by elected officials, and "uncontrollable" expenses imposed by forces outside the governor and legislatures.

Inflation adjustments are routine in national studies, but not made in current projections of some states. As a result, state employee salary increases are viewed as additions along with such other budget factors as cost-of-living increases for retired workers, reimbursement rates for foster parents and other providers of service, and welfare payment adjustments. Particularly in **California**, such adjustments are built into permanent law as well as in budget projections.

Commitments are made by legislatures and governors in many ways, most significantly in legislation that promises future increases in spending (e.g., school aid formulas with multi-year cost escalation as in **Colorado**) or reductions in taxes (e.g., temporary increases this year in **Rhode Island** and **Vermont**). Because state budget projections assume existing law, locally defined "structural imbalances" are inherent in budget of states like **Louisiana** (which raises much of its revenue from a "temporary" suspension of sales tax exemptions) and **New York** (which has an oft-postponed schedule of phased reductions in personal income taxes). Such commitments are routinely ignored in national projections examining whether there is a structural deficit in state and local finances.

Uncontrollable expenses are defined quite differently from state to state, with contractually committed debt service the only common element.

Some states have, in effect, allowed their corrections, mental health, child welfare, and/or mental retardation agencies to turn their budget aspirations into consent decrees of federal courts. Some states turn court-ordered school finance equalization (requiring equal spending, not high spending) into typical equalization plans which achieve equalization only by increasing aid, not by offsetting increases and decreases. With both these situations, the **Texas** budget easily gives rise to the conclusion that it is structurally out of balance. Constitutional mandates of school funding increases in **California** and **Louisiana** are extreme examples of restrictions leading to imbalance. Measure 5 in **Oregon** and a November ballot measure in **Michigan** (both mandating property tax rollbacks with the state making up lost local revenue) are also extreme examples.

Shots In The Fiscal Foot, Imbalance In FY 1994

In the last few months, there has been a surge of discussion about budget balancing problems for FY 1994. **Montana** legislators concluded their recent special session with bipartisan agreement that their solutions weren't permanent. These included accruing unreceived revenues and delaying school aid payments. **Washington**'s retiring governor warned that the legislature successfully got out of town this year only by leaving a major imbalance for the next biennium. In states with significant reserves, like **Indiana** and **Minnesota**, use of reserves to finance this year's spending raises the question of how to pay for next year's.

Vermont is a good example of creating future problems. By running deficits and covering costs with borrowing, the state has $65.5 million in debt to pay while its "temporary" taxes are scheduled to expire. **Maine** has a worrisome collection of problems to face in its new biennial budget to be considered next year: (1) loss of over $250 million in revenues from temporary tax increases, (2) a $40 million pay hike already adopted combined with the loss of furlough days that offset its costs, (3) the scheduled expiration in June of a pay cut associated with shorter employee work-weeks, (4) a postponed $70 million payment to the retirement system, (5) replacing one-time revenue from accelerated tax collections, and (6) using borrowed funds to make a debt service payment.

While some state officials may choose to consider these situations as indicative of structural imbalance, they are phenomena associated with this year's high propensity of state officials to avoid tough choices like spending cuts and tax increases.

Assessing Fiscal Stress, FY 1991

Gold used statistics on state economies, like the Index of State Economic Momentum and its components, and information about state budgets, like reported balances, to construct a fiscal stress index for FY 1991. The results are on the table.

Fiscal Stress Rankings, FY 1991 (Largest Rank Number = Most Stress)

Rank	State	Rank	State	Rank	State	Rank	State
1	Oregon	14	West Virginia	27	Indiana	39	Pennsylvania
2	Nevada	15	New Mexico	28	Illinois	40	Maine
3	Washington	16	Kentucky	29	Alabama	41	Michigan
4	Montana	17	Louisiana	30	Delaware	42	Vermont
5	Nebraska	18	Texas	31	Tennessee	43	California
6	Alaska	19	Kansas	32	Ohio	44	New York
7	South Dakota	20	Arkansas	33	Florida	45	Maryland
8	North Dakota	21	Colorado	34	New Jersey	46	Virginia
9	Hawaii	22	Wisconsin	35	South Carolina	47	Massachusetts
10	Utah	23	Minnesota	36	North Carolina	48	Connecticut
11	Wyoming	24	Arizona	37	Georgia	49	Rhode Island
12	Oklahoma	25	Iowa	38	Missouri	50	New Hampshire
13	Idaho	26	Mississippi				

Gold's index, the Economic Momentum Index, and single data series like the employment changes presented elsewhere in this issue can provide significant insights into state fiscal problems and likely actions. But they inherently rely on data, which means they are backward looking. Gold's index cannot yet be updated for FY 1992, but most state officials are now arguing about their concerns for FY 1994.

Fixing Fiscal Balance: The joys of having a structurally balanced budget, even if it is subject to deficits in recession and surpluses in recovery, were articulately presented in a recent report on New York City finances:

> *A structurally balanced financial plan permits stabilizing service delivery and thereby anticipating employment needs better so that expansion and contraction in agency staffing can be accommodated as completely as feasible through attrition and voluntary transfers. Hiring in one year to be reversed the next year with freezes or layoffs is minimized, because the structure of expenditures that led to the hiring is sustainable over time. Service recipients value this stability because service delivery is more reliable from year to year and, indeed, within a year. Organized labor values it because layoffs are avoided and evolving manpower needs are handled by managed attribution, which is least disruptive to union members. Managers also favor this stability, which allows them to develop staff and to focus their time less on budget changes and more on improving service delivery without raising costs. The business sector favors structural stability because it gives businesses predictable tax and service policies that are necessary for effective business planning. Other taxpayers favor it because they can reliably know their tax obligations and the services that they can expect from government.*

Another benefit of structural balance is that priorities created in one year's budget are sustainable so that agencies can reasonably plan service demands and manpower needs over a multi-year period. Program reversals, and the sizable inefficiencies they create, are minimized. The enhanced ability to sustain priorities and to maintain stable service delivery permits substantially increased focus on the purpose and mission of agencies and on the ability of the budget to accomplish that mission. Without reasonable year-to-year stability, repetitive budget-cutting exercises occur under relatively short time frames, which permit little opportunity to design expenditure reductions that achieve the necessary savings and at the same time preserve the top priorities and mission of the agencies.

Without structural balance, there can be little assurance that spending cuts can be restored in the next several years or that temporary tax increases may expire. In contrast, if the financial plan were structurally balanced, one could have realistic expectations whether certain cuts were permanent components of restructuring finances or were merely temporary steps to weather a severe recession. Because structurally balanced budgets may still have deficits during economic recessions, spending reductions or tax increases will still need to occur, but will be temporary or transitional until the economy recovers and budget surpluses emerge.

ECONOMIC DEVELOPMENT STRATEGIES

State competition for new factory and office locations remains intense, more restrained by the lack of new investments to finance than by state and local reluctance to provide tax concessions, sites, infrastructure, worker training, and other incentives. The latest big deal is BMW's new plant in **South Carolina**. The state's incentives, which Business Week (7/6) called "a cumulative $135 million bonanza," include a 900-1,200 acre site and infrastructure improvements on and around the site. According to the New York Times (6/23), the incentives were $145 million, not including the state's current tax credit for employment expansion and a concession on water and sewer costs. Many states joined the early competition for the plant, with **Nebraska** apparently the runner-up.

South Carolina has enjoyed considerable success in attracting foreign manufacturing investments in the past two decades, including Michelin (French tire company) which now has four plants and 5,400 workers in the state. German auto manufacturers, unlike Japanese car builders, don't have much of a track record in the U.S. Volkswagen, with state subsidies that were the precursor of the present auto deals, opened a major facility in **Pennsylvania** that closed after a decade of high costs, low sales, and quality control problems.

Localized cross border wars over development continue in many areas. Examples are the competition between **New York** and **New Jersey** for office workers, an intensively hot competition between **Ohio** and **Kentucky** for manufacturing in the Cincinnati area, and the continuing competition between **South Dakota** and **Minnesota** for any kind of development.

States continue to compete in finding export opportunities as well as attracting foreign investment. According to a survey by the National Governors' Association, states spent nearly $100 million on international operations in 1991, including the 41 states that maintain 163 offices in 26 different countries and 27 governors that made 29 trips to 21 different countries. NGA figures show that states spent $211 million on tourism promotion in 1991, over ten times federal spending for tourism.

States are extending their activities to encourage successes by home-state firms as well as encouraging newcomers. There are new general incentives in state tax revisions this year, like R&D and employment expansion credits in **Connecticut**. A new report indicated that 28 states now have substantial technical assistance activities known as industrial extension programs. There is a continuing pattern of special exemptions designed to lure particular firms.

However, there are signs of trouble on the smokestack chasing front. The normal ebb and flow of business success and failure, exacerbated by recession, have left many local governments with the bill, but without the benefits, of subsidized development. Aircraft manufacturer McDonnell Douglas, which excited many states with prospects of a new plant, recently announced cutbacks and closing of its facilities in Columbus, Ohio. Northwest Airlines, which nabbed a big subsidy commitment from **Minnesota**, is in financial trouble. Its construction of a maintenance base in Duluth is behind schedule and may be further delayed by litigation over the constitutionality of the state's contribution.

The supercollider, being built in **Texas** with large state subsidies, has encountered difficulties in federal funding. The package of industrial development tax incentives proposed by Governor Weld was nixed by the **Massachusetts** legislature, which opted for spending and an estate tax cut instead. Business protests that the environment for development was being spoiled by high taxes didn't convince **Pennsylvania** legislators to roll back last year's sharp increase in corporate income taxes, nor prevent **Rhode Island** from continuing its "temporary" corporate income tax surcharge or broadening its sales tax base to include some business services.

One significant, but quiet, development was the halt to unbridled tax abatements enacted in **Alabama** this year. It was the only piece of a tax and spending reform package of over 20 bills that made it through the legislature.

The Tax Incentive Reform Act limits the term of abatements (10 years or, if less, the expected life of the property), eliminates them for taxes used to finance education, and requires a separate application including projections of employment gains. Abatements had been a semi-automatic corollary of decisions to finance through tax-exempt revenue bonds. "Private use property," such as city and county land leased for nominal prices for company plants and industrial parks is subjected to new reporting requirements that will indicate the tax losses involved, though not directly curtail them.

When beneficiaries of tax abatements and even state subsidies fail to perform as promised, state and local governments rarely recover their out-of-pocket costs, though they keep what they own (e.g., improved sites and nearby infrastructure investments). One major reason is that contracts either are not involved at all or don't hold developers to either employment increase commitments or payment of specified damages. Nonetheless some jurisdictions are suing for unfulfilled development promises.

Kansas City has sued developers who opted out of a rail station renovation. Most of the $91 million in claims have been rejected in trial court. The city is seeking the remaining $13 million for property tax revenue on office buildings that were built using tax abatements and a road project the developer agreed to finance but didn't.

JOB GROWTH AND DECLINE

The state-by-state employment data released in July suggest total national employment dropped by 448,600 between May of 1990 and May of 1991. The nationwide job loss of 0.4% indicates continuing economic problems. However, it is less than the one-year losses earlier this year and last year, confirming other national data suggesting the recession has bottomed out. Individual states show great variation as shown by the table (next page).

The most striking news is the concentration of the job losses. **California** lost 202,600 jobs in the year, followed by major losses in **New York** (191,200), **New Jersey** (110,300), **Pennsylvania** (64,000), **Massachusetts** (53,500), **Connecticut** (52,600), and **Maryland** (50,500). These states and two smaller Eastern states — **Rhode Island** (8,700) and **Delaware** (6,300) — are the largest percentage losers shown on the table.

Job gains were less concentrated than job losses. Despite a national job loss, 29 states reported gains. The largest single gain was in **Texas** (80,600 jobs), followed by **Arkansas** (28,500), **Indiana** (28,300), and **Minnesota** (25,100).

Percentage Change In Employment, May 1991 to May 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Idaho	3.11%	18	Washington	0.85%	35	Illinois	-0.39%
2	Arkansas	3.10	19	Kentucky	0.76	36	Virginia	-0.40
3	Utah	2.64	20	Alaska	0.65		**United States**	**-0.41**
4	Nevada	2.37	21	North Carolina	0.56	37	Ohio	-0.54
5	West Virginia	2.09	22	Wyoming	0.53	38	Florida	-0.66
6	South Dakota	2.07	23	New Mexico	0.51	39	New Hampshire	-0.88
7	Kansas	2.07	24	Nebraska	0.46	40	Vermont	-1.01
8	North Dakota	1.98	25	Alabama	0.44	41	Pennsylvania	-1.25
9	Oregon	1.72	26	Iowa	0.34	42	South Carolina	-1.51
10	Montana	1.65	27	Georgia	0.30	43	California	-1.62
11	Colorado	1.63	28	Arizona	0.20	44	Delaware	-1.82
12	Wisconsin	1.24	29	Tennessee	0.20	45	Massachusetts	-1.89
13	Minnesota	1.17	30	Louisiana	-0.07	46	Rhode Island	-2.04
14	Indiana	1.13	31	Oklahoma	-0.16	47	Maryland	-2.39
15	Texas	1.12	32	Michigan	-0.26	48	New York	-2.41
16	Mississippi	0.94	33	Maine	-0.29	49	New Jersey	-3.14
17	Hawaii	0.93	34	Missouri	-0.30	50	Connecticut	-3.36

There is no correlation between this current indicator of state economic indications and tax actions taken in 1992. Tax cuts were concentrated in poorly performing states such as **Massachusetts**, **New Jersey**, and **Pennsylvania**, though other poorly performing states (**Florida**, **Maryland**, and **Rhode Island**) raised taxes. Some of the best performing states (e.g., **Colorado**, **Kansas**, and **Montana**) also raised taxes. Considerable bad news is already reflected in the budgets enacted in **Connecticut** and **Rhode Island** and is reflected in the continuing budget deliberations in **California**. The other states on the bottom of the table may have bad fiscal news to come. **Maryland** is already reporting shortfalls.

TOTAL QUALITY MANAGEMENT

With the governor's leadership in total quality management, this is the time to rethink and retool our fundamental approaches to management and leadership. — Texas Mental Health And Mental Retardation Director quoted in Austin American-Statesman (7/28).

We don't have anything to do with the MHMR program. — Texas governor's press secretary quoted in Austin American-Statesman (7/28).

Controversy over spending about $1 million on Total Quality Management (TQM) programs in one **Texas** agency is indicative of controversy across the country about the value of the newest trend in private and public sector management. The issue broke into the Texas press when the mental health agency announced it was spending over $200,000 (not counting staff time) to provide statewide taped seminars by W. Edwards Deming, the guru of the TQM movement, as part of its new management approach. Critics contended the agency should be spending its money on improving patient care.

The Texas agency isn't alone in its interest in TQM and related approaches. The Federation of Tax Administrator's meeting this summer featured presentations on state tax agency use of TQM in **Minnesota** and **Wisconsin** and a **Colorado** Department of Revenue paper on "Use of Private Sector Principles of Sound Management." The American Association for Higher Education has started an "Academic Quality Consortium" to bring together universities for information exchange about TQM. The one sentence appraisal by the Chronicle of Higher Education (8/12) illustrates controversy in all state operations over whether the approach is new or helpful:

> *Across the country, colleges and universities report success with the technique, even though some skeptics say Total Quality Management is just the latest jargon for the kind of collaboration and shared governance that many colleges and universities have long practiced.*

The quality management issue was debated at a full day seminar at the NCSL meeting in July. Other NCSL sessions also highlighted the concept of TQM and the book by David Osborne, Reinventing Government. Speakers, as well as those in the audience, varied in their enthusiasm. One told legislators that they are "going to have to get into this" and promised the TQM approach would help legislators "regain citizen trust." She described the process of getting state managers to adopt TQM principles as like religious conversion.

Another TQM advocate criticized standard state "one-size-fits-all" policy approaches and said they could be replaced by "high quality customized services." He stressed concepts of empowering consumers of government services and leveraging private sector resources through state programs. He contrasted TQM's approach of doing without bureaucracy and employing social contracts with service recipients with the liberals' approach of giving bureaucracy more power and the conservatives' approach of reducing government power.

One particularly enthusiastic TQM proponent promised the possibility that "Costs will be down, budgets will be balanced." A handout on the State of **Colorado** program boasted of "improved the way things get done," "fewer errors," "less wasted effort," "better service at lower cost," and "increased satisfaction among state citizens."

NCSL executive director William Pound said changing fiscal circumstances mean states and legislators "have entered a different time." In that context, he contrasted the management approach of TQM with the traditional function of legislators, passing bills. He concluded that legislators might have to improve several functions that some tend to do poorly: planning (citing **Kentucky** and **Florida** as examples of what can be done in legislatures) and legislative oversight. Rich Jones (NCSL staff) said legislators could gain from "results-oriented government." But he warned that the precise definition of goals urged in TQM and other approaches wasn't easy because legislation often embodied compromises that retained differing goals of members voting for approval. He and Hal Hovey (**Reports** editor) pointed out many similarities between the currently popular TQM and other approaches that have had their days in the sun — sunset laws, cost-effectiveness analysis, planning-programming-budgeting systems, cost-benefit analysis, management by objectives, and strategic planning.

Hovey suggested that one reason for the popularity of ever-changing management concepts embodying similar approaches was that the changes allowed new people to exercise leadership and encouraged rethinking of government functions and ways of operating — "getting dead policies and dead people out of power." He suggested that those seeking to change what is done would be well advised to seize whatever new vocabulary was most popular for their advocacy of previously considered positions as well as seizing whatever new insights they might develop from the new approaches.

A recent report from the Rhode Island Public Expenditure Council shows that this is already being done. Rethinking Government — Making It Work is a melding of approaches. It starts with current concerns about state government that serve as motivation — tax and fee increases, reduced school funding, deferrals of spending, and a public opinion poll showing most Rhode Island voters believe the state is headed in the wrong direction. Recognizing government roles in education, transportation, protecting the environment, and creating a climate for economic prosperity, it concludes, "If Rhode Island is to flourish, its governments must succeed."

Two Management Approaches Enacted

Contrasting styles for legislation to improve management are illustrated by two recent enactments. **Tennessee** bought into TQM with the "State Government Quality Improvement Act of 1992." It endorsees the principles and sets up a task force to encourage their implementation. **Ohio**'s governor recently signed a bill implementing 23 of the recommendations of the business-oriented Operations Improvement Task Force. The group made 1,467 recommendations (only 125 requiring legislative action) that are heavily oriented toward specifics like those addressed in the bill — notifying by cheaper methods than registered mail, capturing welfare overpayments from tax refunds, and more use of halfway houses for prisoners in the last 120 days of their sentence.

The Rhode Island report cites concerns common to all states, asking: (1) How can policy be more investment oriented, dealing with early childhood programs, worker training, and infrastructure? (2) How can more emphasis be placed on self-sufficiency rather than income maintenance? (3) Can the state afford not to attack root causes of crime rather than incarcerate criminals at $30,000 per year each? and (4) What should be the priority and funding mechanism for health care?

After suggesting a revitalized state government should be "customer-driven, user-friendly, knowledge-based, results-oriented, accountable, and flexible," the report moves to specifics. Those specifics— drawn from past reports of blue ribbon groups, the council, and others — include some old standbys like reorganization of state government, sorting out state and local government roles, a management information system, personnel reform, linking budgeting and policy development, and having four-year terms for the governor.

MISCELLANY

Budget Wrap-Up

In Issue 15, three states that hadn't finished budget deliberations were listed as possibly facing major fiscal problems next year if they opted not to deal with them in their FY 1993 budgets. **Michigan** adopted a budget well before the October beginning of the fiscal year that doesn't raise taxes, but does leave problems for next year. Those problems will be exacerbated if the governor's "cut and cap" property tax relief measure is adopted by voters in November. Much of the planned state revenue growth would be used to compensate for the school property tax cut while considerable local revenue growth will be cut off by the cap. **Rhode Island**, where the budget was delayed until after July 1 by an unrelated water supply issue, bit the bullet with a combination of spending cuts and tax increases. **California** is moving toward a resolution involving less money for universities than last year, welfare payment cuts and eligibility restrictions, sharp cuts in state operations (e.g., parks and recreation), and shifts of state financial pressures to local governments, which may get new taxing authority to deal with them.

Privatization

As **Reports** periodically points out, the subject of *privatization* is producing much talk but little activity in such obviously privatizable areas as state operation of liquor stores and insurance funds. Part of the reason is that privatization advocates tend to be doctrinaire on the inherent superiority of private over public operations, to work poorly or not at all with public employee unions, and to tackle politically tough cases (e.g., vouchers for private schools and contracting out prisons).

The major steps in moving functions to the private sector are being made where privatization isn't the issue -- substitution of community mental health for state institutions for therapeutic reasons and shifting publicly operated hospitals to the not-for-profit sector to improve access to Medicaid and insurance reimbursements.

While some **Michigan** elected officials have sounded doctrinaire on the subject, Michigan's current approach to the subject (which acknowledges debts to the State of **Georgia**) is clearly pragmatic. The governor has asked a seven-member group (including state and private sector management and labor) to assess a new 62-page report on privatization opportunities. The report considers where privatization may be appropriate and inappropriate and provides detailed lists of functions that should be considered for privatization. Contracting out corrections functions entirely and school voucher plans are notably absent from the lists, which concentrate on functions which have private sector counterparts.

The report will probably draw criticism because it isn't symmetrical — there is no review of functions done privately that might be shifted to the state to match the list where the reverse is being considered. But privatization critics will find considerable solace in the circumstances under which the report suggests the state shouldn't privatize:

> The task is uncertain at the outset and prone to revision.
>
> The value of the production is hard to measure.
>
> It is very disruptive to switch contractors in mid-stream.
>
> The unit of government knows the best means to accomplish the task.
>
> Process is as important as the end result.

TECHNICAL NOTES

Prisoners: The periodic reports on corrections populations come from the U.S. Department of Justice. The state data shown come from its publication Prisoners In 1991, which includes federal prisoners (less than 10% of the total, not enough to distort state comparisons) and excludes local jail populations except when state authorities lease local jail space for state prisoners. The $35,000 cost of a prisoner-year used in the text is substantially above the numbers most often used, which are more like $25,000. Those statistics come from correctional agencies, which fail to include massive centrally budgeted costs including their own agency overheads, state overheads (e.g., state personnel departments, attorney general personnel used to defend corrections officers), and centrally budgeted state costs which often include tort claims payments and employee life insurance and sometimes health insurance, pension contribution, and more.

For state-by-state data on changes from 1980 to 1990 in prisoner counts and state spending, see Sarah Ritchie, The Growing Problem Of Corrections For American States (Center for the Study of the States, 411 State St., Albany, NY 12203). The data on probation and parole come from the Justice Department publication Probation And Parole 1990. Data on crime rates and additional corrections statistics will be found in States In Profile.

Structural Deficits: The most articulate presentation of the perspective that state and local governments have built-in deficits appears in Steven Gold's book (published by the National Conference of State Legislatures in 1989), The State Fiscal Agenda For The 1990s. The view that there is a structural surplus appears in the 1986 U.S. Treasury Department study, Federal-State-Local Fiscal Relations. For the perspective that, with the right assumptions and some effort, state and local governments in the aggregate can provide current services with current revenues, see Harold A. Hovey, "Who Pays When State Health Care Costs Rise?" in U.S. Advisory Committee on Social Security, State Governments: The Effects Of Health Care Program Expansion In A Period Of Fiscal Stress (1991). Gold's stress index appears in State Tax Notes (8/3). The long quote on the benefits of structural balance is from the agency that oversees New York City finances (New York State Financial Control Board, Structural Balance, July).

Economic Development: NGA's statistics on foreign commerce promotion were presented by press release (5/21). Its 81-page report, Increasing The Competitiveness Of America's Manufacturers: A Review Of State Industrial Extension Programs, was released in June.

Quality Management: NCSL has arranged for tapes of most of its annual meeting sessions. NCSL staff members who arrange the sessions are good sources of information on what materials were presented and which experts seem knowledgeable about what. Perusal of shelves at any business-oriented bookstore or the pages of business journals will provide an introduction to TQM concepts. The Rhode Island Public Expenditure Council (300 Richmond St., Providence, RI 02903), which issued its report in late July, is a private nonprofit group oriented to state management and finances that is funded primarily by businesses active in Rhode Island.

A must-read for those interested in varying government-wide management approaches in the states is Recent State Government Reorganization, Productivity, And Management Improvement Efforts (Revised edition, July 1992). This 50-state summary was presented by Frank Mauro (Deputy Director, Nelson Rockefeller Institute of Government) at the NCSL meeting and is available from the Institute (State University of New York, 411 State St., Albany, NY 12203).

Privatization: The Michigan report was published as a draft by the Department of Management and Budget (P.O. Box 30026, Lansing, Michigan 48909) as Privatization In Michigan: Recommendations To The Governor.

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VOLUME 10 ISSUE 17

IN THIS ISSUE

California now has a budget, but hasn't solved its budget problem. Its action concludes an unhappy year for legislators, governors, state employees, and voters.

- What An Awful Year p. 2

Dissatisfaction with finances has drawn new attention to the process for making budget decisions. Budget reform's popularity may have some justification, but it won't solve concerns of those who want to spend more and tax less.

- Reforming The State Budget Process p. 8

States have been struggling to put enough new money into schools to cover enrollment growth and inflation, with success mostly in tax-raising states. Success in education quality is also proving elusive.

- Financing And Reforming Schools p. 13

About half the states are in litigation over financing schools. The threat of litigation is leading to changes even where no cases are in the courts. Cases may become more complex as plaintiffs look to settle adequacy of funding, not just equality of funding, through lawsuits.

- School Finance Litigation p. 15

Recent national projections of school enrollment and problems in making current estimates and projections of population suggest such estimates need to be used with caution.

- Enrollment And Population Estimates p. 18

Miscellany covers deficits, litigation affecting states, and how much states pay nursing homes. Technical notes detail sources and caveats.

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September 1992 (First Of Two September Issues)

WHAT AN AWFUL YEAR

Introduction, California And The Nation

California completed action on the FY 1993 budget in early September. The much-delayed resolution of its budget issues completes state approvals of current year budgets and marks the end of most state legislative sessions for this year. The Golden State's action adds an unpleasant final chapter to stories from 49 other states.

This article, the summary chapter, concludes that it wasn't a good year from any perspective. In fact — from the perspective of liberals or conservatives, Republicans or Democrats, those concerned with good politics (in the sense of keeping incumbents re-electable), or good government (however defined) — it was the worst year since **State Policy Reports** began chronicling state policies ten years ago.

This article summarizes activity across all state policy fields and across all 50 states, using California's budget resolution for illustrations.

California is by no means unique in leaving many fiscal and other problems unresolved. In late August, **Texas** legislative leaders and the governor issued a joint warning to agency heads suggesting a $5 billion deficit if current policies were continued.

> *While Texas state government will have more money to spend in the 1994-95 biennium than what was budgeted for 1992-93, that growth will fall far short of paying for a traditional current services budget.... Lawsuits, court orders, unfunded federal mandates and constitutionally restricted funds continue to fuel spiraling demands on our limited state funds.... {To balance the budget, we must} go far beyond where we can eliminate waste or fat. We may have to downsize agencies, reduce responsibilities and eliminate services.*

Morale And Job Satisfaction

Worrying about how state workers feel about their jobs is not the subject foremost on the minds of the voters. Nevertheless, reasonably high morale is one sign of an effective organization. It is universally cited in the currently popular management literature, though often as a part of concepts like "corporate culture." Morale isn't easy to measure, but the impressionistic evidence is strong that state employees, from elected officials to the service deliverers, are not feeling good about their work.

Legislators Unhappy

The signs of low morale are clearest among legislators. Grousing by experienced legislators about how bad the last session was, though not quantifiable, is probably at record levels. Turnover among legislators between 1992 and 1993 will likely set new records. Polls indicate that the job of being a legislator is more thankless than usual, with anti-incumbent sentiment at all time highs. In many states, legislators are working harder and getting less done. **California** is the best example. The two extra months of budget deliberation didn't produce a budget, or other legislation, that many legislators would like to characterize as outstanding or even above average.

Other legislators have had extraordinary workloads with little to show for it. **Texas** legislators are theoretically in session once every two years, but have participated in many special sessions over the last two years. The main reason was to solve the school financing crisis. But after all their work, that situation is as bad as it can get. The school finance arrangement that resulted from all the changes has been declared unconstitutional by the state's highest court. The property tax that is its cornerstone is being collected despite a decision, not subject to being appealed, that it is unconstitutional, and a deadline of next summer for its correction.

There are other examples: **Alabama** legislators spent most of the year on tax and education reform. They have nothing to show for it except a well-based fear that much of the current tax system (e.g., insurance, solid waste disposal fees, and franchise tax) is in violation of the commerce clause of the U.S. Constitution. Appropriations in the enacted budget are being pro-rata reduced with consequences such as laying off corrections officers in the face of rising prison populations. In **Florida** and **Tennessee**, acrimonious and long debates over spending levels and tax reform ended with little or no reform, enough tax increases to discourage those interested in holding the fiscal line, and too little spending to come close to satisfying the aspirations of those interested in expanded state services. **Nebraska** legislators have spent nearly two years with the substantively and politically difficult problem of salvaging their property tax system.

Governors Unhappy

It hasn't been a good year for governors either. They have made little headway on such important agenda items as health care financing, education reform, and attempts to reduce welfare dependency. The decision by many governors to descend upon Congress to seek relief from federal preemptive legislation in health care demonstrates an increasing recognition that progress on that front is blocked by forces beyond the control of governors. Progress on other fronts has been stalled by combinations of state fiscal problems and economic stagnation, making progress in ending welfare dependency and funding health care difficult.

Governors' fiscal problems, intrinsically serious, became more frustrating for many of them because they often resulted in long confrontations with legislative majorities rejecting the premise of the governor's approach. While this didn't happen in all states, it happened regardless of the fiscal approach taken. Governors Chiles in **Florida** and McWherter in **Tennessee** pushed hard for higher spending and major tax increases, but didn't get them. Governor Florio of **New Jersey** unsuccessfully sought an austere budget with no tax increases, but got what he considers an untenable budget with a tax cut instead.

Governors seeking to hold the line on taxes with deep spending cuts got half a loaf in states like **California** and **Michigan**. Governor Weld got much of the austerity he sought, but none of his tax cut agenda for **Massachusetts**. The new **Mississippi** governor was elected after a campaign against higher spending and taxes, but saw a sales tax increase passed over his veto.

Even governors seeking to deal with fiscal problems by combinations of relatively mild spending cuts and relatively mild tax increases hit problems typified by those of **Illinois** and **Ohio**. Fiscal issues dominated the legislative sessions, as legislators were uncomfortable with both any form of tax increase and with proposed spending cuts.

Having one of the best fiscal situations in the nation didn't help either. Governor Gardner of **Washington** is leaving office after two terms of watching his reform proposals fail in the legislature. He says the state's finances are now in bad shape and that neither candidate for his job is facing up to the problem.

Employees Unhappy

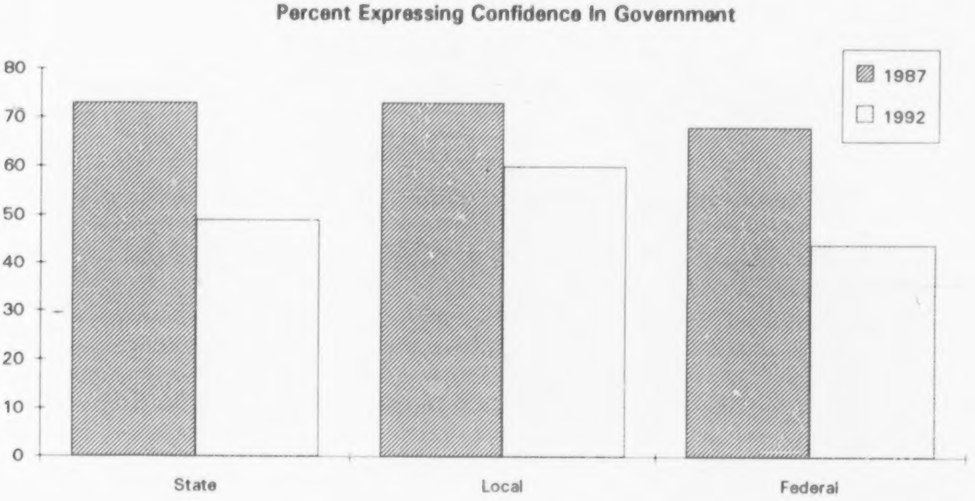
State employees have been operating under the shadow of the budget ax nearly everywhere. **California** employees have been getting their pay in script while waiting to see what form the now-adopted pay cut would take. Hiring freezes, promotion freezes, and pay freezes have been common. Layoffs have been more announced than implemented, but the impact on morale is more often associated with announcements than final action.

The major 1991 tax hikes in **California**, **Connecticut**, and **Pennsylvania** didn't avoid pressures on pay and job security the following year. The story is no more encouraging from **New Jersey**'s 1990 increase, or from the large increase this year in **Maryland**, which has proven insufficient to fund the enacted appropriations. Improvements in state finances aren't always reaching employees. In **Massachusetts**, there haven't been pay raises for some employees in four years, as tax-cutting became this year's priority for state spending and contributing to anything but teacher pay increases became the priority for new state school aid funds.

Customers Unhappy

State employees, from janitors to governors, always feel they are under appreciated by the users of state services. There is probably more justification than ever for such a view. Few state officials are likely to claim improvements over the past year in such fields as social services, university education, and health services. Many state employees in these areas are loudly proclaiming they aren't able to maintain past standards of service.

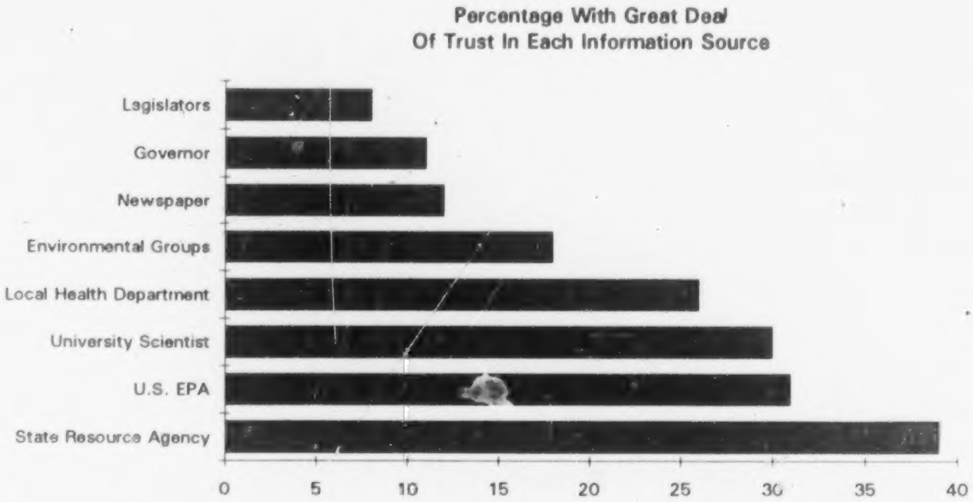
A recent national poll shows the erosion of confidence in all levels of government over the past five years.



The chart shows a dramatic decline in the percentage of respondents expressing either "a great deal" or "a fair amount" of trust and confidence in each level of government "to do a good job in carrying out its responsibilities." It also shows that confidence in local government is higher than in state government, but confidence in state government exceeds confidence in the federal government.

State officials can gain some consolation from the same survey's result when respondents are forced into a choice with the question "From which level of government do you feel you get the least for your money -- federal, state, or local?" In the 1992 poll, 49% of respondents selected federal, up from 36% when the question was asked in 1989. State governments fared best with only 16% selecting it as providing taxpayers least for their money, down from 25% in 1989. Local government was picked by 18%, also down from 25% three years ago.

A recent Michigan poll shows low confidence in elected officials. Respondents were given a choice of indicating a "great deal" of trust, some trust, or even less trust in sources of information about a hypothetical hazardous waste site near their homes. The chart shows the percentages indicating a great deal of trust in the information sources shown.



Frustrations On Major Policy Fronts

The enthusiasm of the late 1980s is gone. The governors are now talking about underestimating the barriers in education reform. Many of the innovations of the 1980s — merit pay and career ladders, state-mandated comparisons of teachers, schools, and school districts, and more — are being dropped or reduced in the face of fiscal constraints and opposition from professional educators. University officials have stopped talking about new quality initiatives and increasingly talk of restricting enrollments and eliminating programs.

Welfare reform measures may have kept welfare rolls from being larger than they would have been, but this abstract victory is obscured by welfare rolls larger than they were. Health care for the indigent costs more, but leaves more indigents without coverage. Adult corrections has literally become a holding action, with little talk of rehabilitating prisoners. Less heralded state services, such as institutional mental health and parks, reflect attempts to maintain the status quo, not new activities.

With exceptions, cutbacks have not provided the major redirection of state policy sought by those who wish to restrict the role of government. Higher education changes exacerbate complaints like large classes, closed courses, and too much time to graduate, rather than providing a new emphasis on teaching. Vouchers and privatization have made little headway. Few states have closed major mental health and retardation institutions.

Summing It Up

In August, the National Governors' Association issued its agenda for the next year. One of the priorities is "redesigning state government," to which the governors hope to contribute with a task force on state management. The announcement of the agenda included this description of how things are going:

> *Unfortunately, Americans are increasingly skeptical about government. The public is frustrated by a lack of responsiveness and accountability, by waste and inefficiency. The result of this frustration is lower voter turnout, citizen-initiated tax and spending limits, and an unwillingness to support new public programs.*
>
> *Citizens used to think that government action could solve many domestic problems. Today many Americans see government itself as the problem.*
>
> *Clearly there are problems in government. We have sometimes oversold new government initiatives. Many program results have fallen short of their promise. Federal mandates have reduced state flexibility and undercut decision-making. In turn, sate mandates have hampered local flexibility and decision making. As programs grow, they become more rigid. Decisions are made by faceless bureaucrats, and as programs are centralized, accountability becomes ever less clear. Everyone takes credit and no one takes responsibility.*
>
> *Our challenge is clear. We must recognize that public skepticism is sometimes justified, that government is not the appropriate tool for every task, and that even well-run programs must change to meet new problems and new challenges.*

Things Are Likely To Get Worse Before Getting Better

The major difference between state policies in the early 1990s and in the last serious recession in the early 1980s is the outlook for recovery. The sharp tax increases of late 1982 and 1983 were followed by a period of rapid economic recovery and swelling state revenues. They permitted program expansions and substantial tax cuts in 1985 and 1986. This year, the combination of reluctance to adopt hard choices between sharp spending cuts and/or tax increases and the slow economic recovery mean that many 1992 problems are simply being carried into 1993.

California is the outstanding example. Elementary and secondary education spending of nearly a billion dollars is being advertised as a loan to the schools, giving next year's legislators the choice of continuing from the base of this year's outlays or using the outlays minus the loan component as the new starting point. Several billions of the California problem was "solved" by one-time measures, so it will have to be solved again next year. Several billions of the California problem wasn't solved at all, just carried forward with funding from revenue growth that seems unlikely to be realized.

The Medicaid Time Bomb

This year's state finances are in much better shape than they could have been. The states were immensely successful in expanding total and federal spending for Medicaid while avoiding double-digit increases in state general fund outlays or the appearance of new taxes. Many state fiscal officials, legislators, and health care executives remain extremely uncomfortable with the devices by which this has been done. No wonder. They rely on two mechanisms which appear untenable as national policy.

The first is paying for health care by taxing health care. The new provider taxes cannot cut the costs of health care to consumers or employers. They have financed higher provider reimbursement rates than would otherwise exist and reduced the pressures for Medicaid cost controls. By increasing the costs of employer-provided plans and self-pay, they have fueled the already substantial pressures for cutbacks in private plan coverage.

The second is forcing federal outlay increases of over 20% per year for Medicaid. No serious plan for cutting the federal deficit ignores this. The implication is: (1) serious efforts at federal budget-balancing aren't in the cards, or (2) the pattern of Medicaid financing will soon be threatened. Either way, state officials don't like the outlook.

REFORMING THE STATE BUDGET PROCESS

> *The people believe it is time to take our destiny in our own hands. In order to restore accountability to our government, we ... find it is necessary to reform the budget process.*

These words from the budget reform amendment package in California could be heard in most states.

The Case Against The Budget Process

Something must be wrong with state budget processes. Opinion polls consistently show that the public believes that states waste money. Voters and many legislators believe that state taxes are too high while spending on what they view as vital services is being neglected. The processes are designed to produce balanced budgets. But spending often deviates considerably from the plan. Agencies administering welfare and Medicaid routinely spend at rates that will exhaust their appropriations by spring — confidently expecting that legislatures will appropriate more rather than halt programs until the new fiscal year. The resulting budgets often aren't balanced.

Besides being unhappy with the results of their state budget process, many are unhappy with the process itself. It starts with a governor's budget that is often immediately denounced as "dead on arrival" or unrealistic. In many states, it continues with mark-up of appropriations bills, which cannot be related to overall fiscal decisions like whether to change tax levels because those decisions haven't yet been made. The process typically nears its end with secretive meetings followed by late-night votes on complex bills that legislators couldn't have read.

After it's over, legislators and the media discover mistakes and provisions that are, at a minimum, embarrassing. Legislators and outside critics condemn the absence of an overall state plan or strategy and the ad hoc nature of the budget's many compromises. They resolve to do better the next time, with many proposals offered to make that happen.

Some states don't get their work done on time, producing at least a sense of guilt and at most closed state offices and missed payrolls. Fears of voter reaction against incumbents helped keep the number of late budgets down in 1992, but California's late action drew national publicity to the problem. Congress does even worse -- sometimes using temporary appropriations for an entire fiscal year, clearly not solving a massive deficit problem, constantly resetting targets so the targets have little or no effect on current decisions, and periodically enacting new budget reforms to replace the last ones after their failure is incontestable.

State officials correctly complain that the federal process counts dollars flowing through the federal treasury as dear but doesn't count dollars extracted from state and local taxpayers through mandates. Local officials, also with considerable justification, make a similar complaint about the states.

Budget Reform Proposals

Nearly everyone agrees that something about state and federal budgets could be better. So nearly every candidate for state and federal office endorses budget reform. Often reform in budget processes is offered as a substitute for hard choices about tax levels, spending patterns, and priorities. A room could be filled with analyses and studies of proposed reforms.

The standard list of budget process reforms includes choices made differently among the states: whether to: (1) use annual or biennial budgets, (2) consider program or line-item budgets, (3) use a zero-base or some other base, (4) begin the fiscal year in July or some other month, (5) leave two months or seven months between executive submission and scheduled enactment, (6) make appropriations in a single bill or many bills, (7) give the governor line item and amendatory veto power, and (8) prohibit or include substantive language in appropriations bills.

Individual observers have preferences for making these choices and arguments for why they like their choices. However, there is little empirical evidence suggesting that one choice is better than another. As a result, much of the budget process reform discussion involves changes with no national pattern, such as moving from annual to biennial budgets in some states and from biennial to annual ones in others.

Spending Limits And Stimulants

Some of the reforms, such as annual rather than biennial budgets and consensus revenue estimating procedures, would appear to be neutral in their effects on the growth of spending and taxes. Other reforms are designed to curb the growth of state-spending. Some of these seem to work. Examples are:

(1) limiting revenue used as a basis for the budget to a number below most likely revenue (e.g., **South Carolina**), such as the revenue realized in the last completed year or a percentage point or two below expected revenue,

(2) making some or all spending contingent (e.g., **Arkansas**) on revenues,

(3) automatically implementing pro-rata reductions in spending when the budget appears out of balance or imposing a *duty* on governors to cut spending to conform to revenues, as was recently used in **Ohio**,

(4) putting constitutional limits on revenue such as indexing for inflation, requiring popular votes to raise revenue (e.g., **Missouri** and **Oklahoma**), and prohibiting certain taxes (e.g. **Florida**),

(5) prohibiting state and local spending, with criminal as well as civil penalties, at rates designed to exhaust appropriations before year-end, and

(6) placing constitutional ceilings on state spending/or taxes like **California**'s Gann Amendment and **Missouri**'s Hancock Amendment.

The effects of other attempts to limit spending growth are more ambiguous. The **California** budget impasse provides an example. California requires extraordinary majorities (2/3 in each House) to adopt a budget, as do **Arkansas** and **Nebraska**. Proponents assume that the result will require high-spending majorities to defer to opinions of low-spending minorities, but the reverse could also prove true. This year, the provision probably restrained spending in California, but could well have worked in reverse in **Florida**. There a bare majority in the Senate was opposed to the major increases in taxes being pushed by the governor. That body could muster enough votes to obtain a majority for the austere alternatives it passed, but probably would have had to made concessions to higher spending to obtain a 2/3 vote.

Some budget reforms are cost-increasing, although their proponents don't typically argue for them on this basis. The argument for them is that "reform" is needed to ensure adequate spending for favored functions. The education spending mandates of **California**'s Proposition 98 and the new **Louisiana** requirement for funding the school aid formula off the top are examples. Many states have adopted multi-year funding programs for school aid and permanent appropriations and/or automatic cost-of-living provisions in some of their programs. Some, but not all, earmarking of revenue has been cost-increasing for overall state budgets. Two clear examples are the earmarking of education money in **Alabama** and devoting **Oklahoma** sales tax revenues to welfare, which was later repealed.

Current Budget Reform Examples

In November, voters in **California** will accept or reject a voter-initiated constitutional amendment being pushed by Governor Wilson. The multiplicity of provisions indicate the many subjects that can be called budget reform. One part provides the governor with power to cut the budget after enactment, if he finds such action is necessary to assure a balanced budget. Such power, including power to cut school aid and other payments exempted by the California amendment, is already in the hands of some governors. Another provision cuts welfare payments in several ways, including an immediate 10% reduction. Another bars legislators and the governor from being paid if the legislature fails to enact a budget by the June 15 deadline. A unique provision would allow the governor to write his own budget, without legislative approval, to deal with a fiscal emergency that would arise if the legislature failed to act on the budget.

In **Florida**, a unique tax and budget reform commission has the authority to put fiscal measures on the ballot without legislative approval. Several such measures are on the November ballot, including budget reform, a taxpayer bill of rights, and local option taxes. The budget reform measures are oriented toward a more open process (e.g., a 72-hour period between introduction of budget proposals and their enactment) and closer ties among budgeting, program assessments, and planning.

At the NCSL Annual Meeting in August, there were several panels which discussed aspects of budget reform. In **Colorado**, the stress is on auditing, linking audit results to the budget process, putting performance measurements in budgets, and a financial reporting system. In **Texas**, where the move to performance measurement in the budget process started twenty years ago, the emphasis is now on special efforts by the comptroller to identify savings and on a statewide strategic planning process linked to the budget process. It draws on earlier experiences of **Florida**, **Louisiana**, and **Oregon**.

Of the presentations at the meeting, **Iowa**'s exhibited the most complete combination of substantive and process changes.

Iowa's problem was perceived as a structural deficit driven in part by built-in increases. In FY 1993, these created a budget gap of $210 million despite a projected revenue increase of 6%. In addition to the usual problems, such as Medicaid, Iowa had substantial built-in increases in its funding formulas for community colleges and public schools, an adverse court decision on state employee salary increases, and several losses in the courts on state taxes of pension income and income of corporate foreign subsidiaries. The solution was to modify formulas, eliminate "standing unlimited appropriations" in favor of annual appropriations, cap certain entitlements, limit certain Medicaid spending and study more limits, ceiling appropriations to 99% of available revenue estimated through a consensus procedure, and establish a new reserve fund.

The Iowa legislature passed legislation requiring five-year plans, implementing periodic program reviews somewhat similar to "sunset" reviews in other states, and requiring the governor to submit a biennial budget. The governor vetoed the legislation because of differences over how the periodic program reviews would work and because he wanted a mandate that the legislature adopt a biennial budget, not just have him submit one. The state also has pilot projects using new budget procedures — zero based budgeting in the natural resource agency and program performance measures in the health agency.

Fighting For Control Over Enacted Budgets

The need to cut back spending from appropriated levels in order to maintain budget balance has produced many executive-legislative disputes over the past several years. A new NCSL report concludes that the dispute over executive and legislative roles is "long-standing," but "it has been enflamed during the past two years because of serious state fiscal problems."

The 93-page study includes survey information from 41 states and analysis of the issues associated with legislative oversight of budget administration as well as allocation of authority for adjusting previously enacted budgets. It also covers recent litigation on the subject in **Alabama**, **Florida**, **Michigan**, and **Wisconsin**. Presentations at the NCSL meeting provided case studies of disputes on executive and legislative roles in **Hawaii** and **Michigan**.

Legislators often have mixed feelings about control over enacted budgets. They recognize that giving governors the unilateral power to change appropriations reduces their authority. But they also recognize the desirability of giving governors and agencies management flexibility and the political hazards of mid-year budget cuts made by legislative rather than administrative action. The study concludes, "Legislators generally are dissatisfied with their level of control over enacted budgets but have been slow to make reforms."

FINANCING AND REFORMING SCHOOLS

Introduction

California's debate over financing schools provided a good example of the national pattern in the FY 1993 state budgets. Unlike other states, **California** has put educators' minimum fiscal aspirations into its constitution: (1) maintaining education's percentage share of the state budget, or, if more, (2) adjusting base year spending by amounts necessary to cover (a) enrollment changes and (b) inflation. But in a no-new-tax environment, the state couldn't meet these standards.

Much of the final delay in enacting a budget involved how to package what was done in relation to these standards. They used exotic concepts such as making part of the FY 1993 school aid a loan against future entitlements under this Proposition 98 formula. One characterization of the California result is maintaining per pupil state aid, adjusting for sharp enrollment growth but not inflation.

Nationwide, the 5.5% increase shown in NCSL's preliminary fiscal survey was enough to cover inflation (3% nationally) and enrollment growth (about 1%). It was not enough to make major progress on agendas for education reform or to adopt new school equalization plans while preventing more affluent districts from receiving less aid than in FY 1992. Excluding states that raised taxes, education money nationwide probably didn't cover current services, that is, adjusting for enrollment and inflation. With property values dropping in a few states and stagnant in many, local money couldn't make up the difference in most states. As a result, education quality and equalization plans are often on hold.

Education Money

While state elected officials again this year sought to raise K-12 education spending more than other programs, it appears that this was unattainable for most states without tax increases. The 5.5% increase reported by NCSL combines large increases in states that raised taxes for education (e.g., **Colorado**, **Kansas**, **Maryland**, **Mississippi**, **Tennessee**) coupled with nominal increases in many other states and cuts in 5-10 states. In **Pennsylvania**, legislators had to decide whether to let the temporary increase in the flat rate income tax expire (which they did) or increase K-12 spending (which they didn't, despite last year's promise of $125 million in new FY 1993 money).

Massachusetts legislators and the governor more or less agreed on about $186 million in new FY 1993 education money, but the deal broke down when the legislature didn't enact the reforms the governor sought.

The governor vetoed the appropriation, but the legislature overrode the veto with the suggestion that the reforms would be addressed in the fall. Unlike the pattern of independent school districts in most of the country, Massachusetts schools are run by school committees under some control by municipalities. Arguing that priorities are unbalanced when police are laid off while schools expand spending, Boston's Mayor Flynn (with support from the association representing Massachusetts cities and towns) has attempted to capture some of the new school money for city operations.

Status Of Reforms

Much of the bloom has disappeared from the education reform rose. This is not only due to state fiscal problems but also increasing recognition of obstacles to rapid change in public education. The problems are indicated by the title of the summary report released by the nation's governors at their annual meeting in August. They called the report, *Redefining The Possible*, and included a subtitle in their press release, *Governors identify barriers and opportunity for change*. The reports on education quality released at the meeting have a different tone from those of the 1980s, which seemed to envision rapid reform as a result of widespread adoption of governors' initiatives.

Governor Ashcroft, leaving office as NGA's chairman, talked of states "grappling with strategies" and commented, "Clearly systemic change is difficult, but it can be done." There was much discussion of a "decade-long commitment." The new NGA chairman, Governor Romer, commented in his agenda for the new year:

> *Standards are meaningless unless all of our citizens — students, parents, educators, employers, and policymakers — understand and support them, and unless they feel personally accountable for achieving them.*

The linkage between funding and standards for reform is suggested by **New Hampshire**. In August, the state school board, on a divided vote, eliminated the state's minimum standards in areas such as limits on class sizes, mandated programs for gifted students, and training requirements for guidance counselors. The state superintendent opposed the move as did several board members, one of whom resigned over how it was handled. Some observers fear that the state constitutional prohibition against new unfunded mandates on local government will prevent the state from ever again imposing standards. Of 162 districts in the state, over 60 have eliminated kindergarten. New Hampshire opted to deal with its financial problems by eliminating most of its previously lowest-in-the-nation state support of public schools.

Many states have been shifting their education departments from a mandating and policing role to a technical assistance role. In **Georgia**, the change is called eliminating a "gotcha" mentality by moving to an attitude of helpfulness.

SCHOOL FINANCE LITIGATION

Equalization Cases Continue

There are about 23 states with school finance litigation pending. The threat of cases is influencing policy in many states where no cases are currently in the courts.

The U.S. Supreme Court decided long ago that the U.S. Constitution doesn't require funding equity, so the current cases rely on state constitutional language. State courts continue to split on the issue of whether state constitutions require equalization. Litigation was rejected in cases in the late 1980s in **Louisiana**, **South Carolina,** and several other states. Plaintiffs won in 1989 through 1991 and have forced major school aid formula revisions (and higher total state outlays) in **Kentucky**, **Montana, New Jersey**, **Tennessee**, and **Texas**.

In many of the states, plaintiffs aren't diligently pressing their suits. Instead, they are using pending litigation as one mechanism to force legislative action. At the same time, they fear the possibility that final court resolution might be adverse to their cause and reduce pressures for legislative action. In some states, defendants aren't pressing their case hard either. The best example is **Alabama**, where the state's case is stronger than most because there is no language on public schools in the state constitution. The governor and other elected state officials have tried to get out of being defendants and join the plaintiffs. The arguments in trial court are more over how much the court should order the state to spend than over whether the school formula violates the state constitution.

Developments In Four States

Using a lawsuit as a pressure device worked in **Kansas**. Last year, the judge didn't bring the case to trial, but did issue a memo on the principles of constitutional school finance. The legislature revised the school aid formula this year — increasing equalization, total school funding, and state taxes in the process. In May, the judge dismissed the pending action, though some disappointed districts are talking about starting new litigation.

In August, the **New Hampshire** equalization suit lost at the trial court level. The decision will be appealed. The court found that the state's constitutional requirement deals with a duty to "cherish ... public schools," not tantamount to a requirement of equity or adequacy of education. The Granite State, which has massive disparities in tax base per pupil among its many small districts and the lowest percentage of school costs paid by state aid of any state, has some of the least equalized school finance arrangements in the nation. In the last several years, it eliminated its small equalization program as an austerity measure, except to the extent that state-funded equalization is covered by lottery proceeds.

The most significant of the unresolved school finance issues is in **Texas** where the state supreme court has insisted on equalization and the legislature has responded with more money and a succession of equalization plans. The latest was rejected by the court on non-equalization grounds. The use of county education districts with county-wide tax bases was found to violate a prohibition in the constitution against statewide property taxes. The state court made its invalidation of the tax prospective, to take effect next summer. A federal court declined to overturn this unusual approach of permitting collection of an admittedly unconstitutional tax. It decided that no substantial federal question was presented.

The governor talked earlier this year about a summer 1992 special session to resolve the issues. She dropped the idea after it became clear that no plan seem likely to get a majority in the legislature. A special session after the November elections is likely. Meanwhile, promised state aid is being prorated, so districts get only a percentage of the money the formula indicates they should receive. The problem was caused by underestimating both enrollments and local tax effort, both of which are elements of the Texas formula. The prorations were designed to save about $240 million in FY 1992 and more than $500 million in FY 1993.

This spring the governor announced a plan that would move the entire business property tax system to the state, eliminating most of the disparities among districts. The resulting revenue would be used to equalize funding under a first tier traditional foundation formula. It sets target spending based on the number of pupils, subtracts required local effort based on a statewide tax rate and the local property tax base, and requires the state to pay the rest. The second tier would provide an increment of funding whereby equal additional local tax effort would produce equal increments of revenue regardless of differing local tax bases, because the state would make up the difference for poor districts. The third tier would consist entirely of local effort.

The 1976 **California** decision in Serrano v. Priest is a landmark for plaintiffs in school finance litigation under state constitutional provisions. Since then, California (along with **New Mexico**) has been maintaining one of the most equalized school finance arrangements in the nation. This hasn't prevented further litigation by the Association of Low Wealth Schools. Tired of the process, the state itself has initiated litigation to get state courts to reaffirm the Serrano case and put an end to further litigation and discussion.

Measuring Disparities In Funding

There are many different ways to assess funding disparities. The simplest is to compare per pupil spending, with no adjustments for differences in local tax effort or cost-driving factors, such as disadvantaged students or substantial transportation requirements, that might cause differences in spending.

Comparing the highest spending district to the lowest shows the maximum disparity, even when the comparison excludes districts with less than 50 students. This comparison is shown for some representative states in the table.

Highest And Lowest Per Pupil Spending Per Pupil

State	Highest	Lowest	Difference	Ratio
Florida	$5,489	$3,836	$1,653	1.4
Arkansas	5,843	2,081	3,762	2.8
Arizona	8,023	2,714	5,309	3.0
Pennsylvania	9,504	3,148	6,356	3.0
Massachusetts	8,634	2,817	5,817	3.1
Michigan	8,407	2,491	5,916	3.4
New Jersey	11,820	3,074	8,746	3.8
California*	11,740	2,692	9,048	4.4
New York*	19,238	3,127	16,111	6.2
Illinois	14,316	2,253	12,063	6.4
Texas*	14,514	2,150	12,364	6.8
United States	22,329	1,975	20,354	11.3

* FY 1991 data, other states show FY 1990.

New Issues In The Cases

Some of the recent suits raise issues beyond the traditional one of providing roughly equal spending among districts within a state with roughly equal local tax rates. The new issues involve: (1) capital facilities as well as operating costs, (2) claimed special needs such as those of disadvantaged pupils in urban areas, and (3) the question of whether state aid is adequate, as distinct from whether it is equitably distributed. Adequacy cases are now active in **Alabama**, **Connecticut**, and **Louisiana**. Given favorable rulings in any of these cases, they could quickly become a nationwide phenomenon.

Desegregation Litigation

Spurred by successes of the Kansas City, Little Rock, and St. Louis school districts in getting a special pipeline to state money, school districts in other states are litigating to remedy past segregation. There is a case in federal court in **Georgia**, for example. **Missouri** is spending nearly 10% of its general fund budget on St. Louis and Kansas City remedies. It is continuing to contest the spending mandates, which give these urban districts considerably more state aid than other areas of the state.

A **Connecticut** case attempts to deal with predominately minority Hartford schools and predominately white schools in the Hartford suburbs by relying on both the education and the equal protection clauses of the state's constitution.

Many school districts remain under varying degrees of federal control resulting from a long line of desegregation cases. The March U.S. Supreme Court decision in Freeman v. Pitts, involving an Atlanta area school district, was generally viewed as facilitating reduction of federal supervision in these cases. In that divided opinion, the court's majority found that, "Racial balance is not to be achieved for its own sake." Instead, "Once the racial imbalance due to the *de jure* violation has been remedied, the school district is under no duty to remedy imbalance that is caused by demographic factors."

The case involves the De Kalb County schools, which shifted from only 5% minority enrollment in 1969 to about 50% in 1986, and two-thirds currently. State funding is generally not directly involved in these cases, but many states have responded indirectly to the special costs of districts affected by past desegregation orders.

ENROLLMENT AND POPULATION ESTIMATES

Introduction

With many people worried about structural budget imbalance, demographics has become an important subject. School enrollment changes are driving part of the budget problem in **California** and are responsible for school aid cuts in **Texas**. The Census Bureau decided to ignore possible undercounting of population for purposes of reapportionment, but must reconsider the issue in determining federal aid to state and local governments.

Population Counts

The enumerated count of population from the 1990 Census was 248.7 million, but Census Bureau experts estimated that the actual U.S. population was 254.0 million, an *undercount* of over five million. The methods used to estimate the undercount were national ones, so the Census Bureau is unsure of how it might be allocated among states and even less confident about how it might be allocated among Congressional districts, counties, and cities. For this and other reasons, the Bureau decided not to use the undercount for its estimate of 1990 population used for both federal aid and reapportionment.

Now the Census Bureau faces the problem of what estimates to use between Census years (1990 and 2000) for many important purposes including the annual estimates of state population and the local estimates made every other year.

To complicate its problem, the Bureau has decided its original estimate of undercount was inaccurate due to "a significant computer processing error" and further research. It now estimates the 1990 population, which is the starting point for 1991 and subsequent year estimates, was 252.7 million. Options for adjustment of the 1990 baseline range from making none to adjusting the estimates for every jurisdiction in the U.S.

The new undercount estimate would, if used, adjust population upwards substantially in **Texas** (2.8%), **California** (2.7%), **Arizona** (2.4%), **Georgia** (2.1%), and smaller, mostly Sunbelt, states. Lesser adjustments would be made in most Northeastern and Midwestern states. Making the adjustments would shift money (relative to allocations with no adjustment) to the states with the largest undercounts. Because the formula used for AFDC and Medicaid is based on a state's per capita income relative to national per capita income, adjustments would also increase the federal cost sharing percentage for some states with large undercounts. The more affluent of those states wouldn't be affected because they would get the minimum 50% federal share under either population count.

Predicting School Enrollment

> *Some of the projections strain credulity. In other words, they appear seriously flawed.* -- Steven Gold, April 1992

Most states got a big break from fiscal pressures in the 1980s because their public school enrollments didn't grow, while the number of workers contributing tax revenues grew substantially. The situation will be less favorable in the 1990s, but there is disagreement about how much enrollment is likely to increase. One doesn't need to look beyond the presumptive oracle on the subject, the U.S. Department of Education, to find the disagreement. In 1990, DOE's National Center for Educational Statistics (NCES) advised that public school enrollments would grow by 7% over the 1990s. In 1991, DOE advised they would rise 13%, inspiring the comment quoted at the beginning of this article.

Growth of 7% is a comfortable rate of national change for state finances, well below the growth of taxpayers in the same period. The 13% rate is less comfortable, but not as serious as pressures likely to come from Medicaid costs, federal mandates, and increases in inmates and child welfare cases. Nationally, the major difference between the two numbers is the shift by NCES from Census Bureau "medium" to "high" population projections. The difference relates to assumptions about in-migration to the United States and birth rates. The high projections imply higher state costs, without corresponding revenue, for AFDC, Medicaid, and programs to serve children, as well as for education.

On a state-by-state basis, it is reasonable to try to relate the NCES numbers to three anchors: (1) recent enrollment changes in the state, (2) local projections of future enrollment, anchored by the fact that practically all children to be enrolled in the 1990s are already born and most are in school, and (3) recent demographic trends in the state. The table below is designed as a checklist. It compares the NCES projection converted to an annual increase with the increase in school age population from 1990 to 1991, also converted to an annual increase.

Two Views Of Possible Enrollment Growth In the 1990s

Rank	State	Census	NCES	Rank	State	Census	NCES	Rank	State	Census	NCES
1	Nevada	6.3%	0.1%	18	Missouri	1.5%	1.2%	32	Pennsylvania	0.7%	1.1%
2	Alaska	4.1	3.0	18	Nebraska	1.5	-0.8	35	S. Carolina	0.6	1.0
3	Washington	3.5	-0.4	20	Georgia	1.4	2.1	36	Illinois	0.6	2.1
4	Idaho	3.0	-0.4	20	Vermont	1.4	1.8	36	Maine	0.6	2.3
5	Florida	2.9	2.5	22	South Dakota	1.4	1.0	36	Michigan	0.6	1.0
6	Oregon	2.8	-0.2		**United States**	**1.4**	**1.3**	36	N. Hampshire	0.6	3.3
7	California	2.6	1.8	23	Virginia	1.3	4.0	40	Ohio	0.5	0.0
8	Colorado	2.4	0.8	24	Hawaii	1.1	4.7	41	Louisiana	0.3	1.4
9	Minnesota	2.2	-0.2	24	Iowa	1.1	-1.0	42	Indiana	0.2	0.1
10	Maryland	2.1	3.1	26	Montana	1.0	-0.5	42	Massachusetts	0.2	1.7
10	New Mexico	2.1	3.5	27	Connecticut	1.0	1.6	44	Alabama	0.2	0.7
10	Utah	2.1	1.1	28	Wyoming	0.9	-0.8	44	Arkansas	0.2	0.5
13	Wisconsin	1.9	-0.6	29	North Carolina	0.8	2.9	44	Tennessee	0.2	1.2
14	Delaware	1.8	2.0	29	Oklahoma	0.8	-1.4	47	Kentucky	0.0	-0.1
15	Texas	1.8	-0.1	29	Rhode Island	0.8	1.3	48	North Dakota	-0.1	-0.8
16	Kansas	1.7	0.2	32	New Jersey	0.7	3.9	49	Mississippi	-0.2	1.2
17	Arizona	1.6	1.6	32	New York	0.7	1.9	50	West Virginia	-1.4	-0.7

Even the most casual scrutiny of the table shows that there are incredible disparities for some states. The disparities are most severe for states with uneven economic performance over the past decade. For example, the population counts reflect the recent prosperity of the Northwest. The historical method used by NCES has these states mired in mid-1980s economic problems. Conversely, New England states get credit in the NCES projections for late 1980s prosperity while the Census counts reflect the downturn of the 1990s.

Skepticism May Be Warranted

The lesson from the table and from the last decade of population projections from all national sources, private and public, is that national projections are not to be trusted.

Population in general, and school enrollment in particular, respond to the economic circumstances of the time. Many factors affecting those circumstances — war and defense spending, oil prices, the competitiveness of U.S. manufacturing — are not easily predicted.

Individual states have an advantage, which not all of them use, of being able to make their fiscal and other projections (e.g., those used to plan transportation and higher education investments) consistent. That is, projections of prosperity would affect state revenues and employment as well as enrollment. That way overestimates and underestimates will tend to cause consistent adjustments in both revenue and spending.

This safeguard in the state estimates works only if the demographic projections used for spending estimates are consistent with the economic and demographic projections used for revenue estimates. This linkage is made consistently and in considerable detail in some states, such as **Florida**, but not in all states.

MISCELLANY

Deficits

NGA's new chairman, Governor Romer (CO), called reducing the federal deficit the "number one priority" for the group's executive committee. He warned the deficit has increased interest rates, reduced capital investment, and slowed economic growth. He said:

> *We must build the political will in our states and in the nation that is needed to make some tough choices. Inaction is in itself a choice — and it is a disastrous choice.*

The federal and state news on the deficit front hasn't been good. The Congressional Budget Office August update projects a total federal deficit of $331 billion (5.3% of gross domestic product) in FY 1993. Unlike many past projections, automatic improvement isn't in the long-term forecast. CBO sees the deficit, without policy change, dropping to $254 billion in FY 1996, but rising to $290 billion in FY 1997. OMB is somewhat more optimistic about the long-term outlook, but more pessimistic in the short term.

The estimates imply bad news for states in the Medicaid program. CBO suggests 13% annual increases in the mid-1990s. OMB suggests even faster growth. One concern of the governors is the often-proposed cap on federal spending increases for Medicaid and AFDC. Romer urges that any cap control state and federal costs, "rather than reducing the federal share and shifting the costs to states."

Driven by Medicaid, federal aid to state and local governments is continuing to grow much more rapidly than other income. In the second quarter if CY 1992, preliminary Department of Commerce estimates show grant growth of 12% versus growth in state and local income taxes of 5.6%, in sales taxes of 6.9%, and in property taxes of 7.1%.

Excluding surpluses at all levels of government in social insurance funds like Social Security and employee retirement, the second quarter CY 1992 deficits (seasonally adjusted at annual rates) were $44 billion for state and local governments and $331 billion for the federal government. With the insurance funds, the state and local sector had a surplus of $14 billion, but the federal government had a deficit of just over $300 billion.

Getting Beat Up In The Courts

There is no recent single issue or dramatic court decision to illustrate how state policy decisions are faring in the courts. However, the sheer volume of litigation over the past year has been significant. Examples: (1) the school formula litigation discussed in this issue, (2) litigation on the fairness of distribution of state funds for higher education, (3) litigation over state budget-cutting measures, particularly the efforts to limit state general assistance spending, (4) cases involving state taxing power including ability to tax mail order sales and foreign earnings of corporations and to apply differential tax provisions to in-state and out-of-state firms, (5) threatened litigation on Medicaid reimbursement rates, and (6) mandates of spending despite the absence of appropriations.

The states aren't losing all these cases. They have won some key ones, such as judicial approval of California's Proposition 13 effects on property taxes. The legal environment for avoiding court supervision of state corrections and mental health institutions is better than several years ago. States and local governments are generally winning cases seeking to avoid liability based upon exercises of discretion (e.g., not taking a child away from natural parents, allowing parole) that don't work out well.

However, the volume of litigation is having an impact. As the school finance cases illustrate, the cases are expensive to litigate and can result in expensive action to avoid final court decisions. Even when states prevail on appeal, lower court decisions, particularly injunctions, can significantly affect state policy at key times. An example was the court-ordered distribution of Medicaid funds while California lacked a new budget.

Health Care Provider Reimbursements

The conventional wisdom is that state reimbursement rates for health care providers are significantly below their customary charges. State-by-state comparisons of private and Medicaid rates are difficult for many reasons, such as differences in services provided and populations served and incomplete reporting of private charges.

When such comparisons appear, they often raise more questions than they answer. The table provides a recent example. It comes from new data (available only for the 33 states shown) on nursing home daily rates paid by Medicaid and private patients.

Ratio Of Private To Medicaid Nursing Home Rates, 1989

Rank	State	Ratio	Rank	State	Ratio	Rank	State	Ratio
1	Rhode Island	0.41	12	Texas	1.10	23	Wisconsin	1.25
2	New York	0.51	13	Louisiana	1.11	24	New Mexico	1.26
3	Minnesota	0.86	14	Colorado	1.13	25	Missouri	1.46
4	Kentucky	0.88	15	Wyoming	1.13	26	Vermont	1.50
5	Michigan	0.93	16	Montana	1.14	27	Alabama	1.56
6	Tennessee	0.97	17	Florida	1.16	28	Maine	1.58
7	Oregon	0.99	18	Idaho	1.19	29	New Jersey	1.61
8	Ohio	1.06	19	Virginia	1.20	30	Connecticut	1.68
9	Delaware	1.08	20	Illinois	1.23	31	Georgia	1.82
10	North Carolina	1.09	21	California	1.25	32	Utah	1.96
11	South Carolina	1.10	22	Massachusetts	1.25	33	Nevada	2.04

If states pay somewhat less than private patients, the ratios would be in a range of just over one to one. Allowing for problems in the data, the range from 0.9 to 1.26 is probably in the ballpark. The other results beg investigation. Four states are apparently paying much more for Medicaid than private patients pay, twice as much in **New York** and **Rhode Island**. Conversely, eight of the states shown have Medicaid rates a third or more below private rates, including **Connecticut** which mandates that Medicaid nursing home services be identical to those provided private patients.

TECHNICAL NOTES

Awful Year: For a more detailed assessment of the California action and outlook, see Issue 17 of State Budget & Tax News. The public opinion poll cited is the annual one by the Advisory Commission on Intergovernmental Relations (800 K St., NW, Washington, DC 20575), Changing Public Attitudes On Government And Taxes 1992. The Michigan poll is from Public Opinion Monitor (August, published by Public Sector Consultants, 308 S. Washington Sq., Lansing, MI 48933).

Budget Reform: There is little empirical evidence on the impact of budget reforms. First, there isn't complete agreement on what successful reform means — slower spending growth? adoption of budgets well before the beginning of the fiscal year? or someone's view of more rational allocations among programs?

Second, while it is easy to study the correlation between features of a budgeting system, such as use of annual or biennial budgets or presence or absence of line item veto, and fiscal outcomes, such as spending growth rates, so many other factors affect the outcome that it is nearly impossible to associate the outcome with the budget process variable. For a more detailed discussion of reforms, see Vol. 8, Issue 18 (Sept. 1990).

Cassette tapes of the budget reform and other major sessions at the NCSL meeting can be ordered from First Tape, Inc., 770 N. LaSalle St., Chicago, IL 60610. The new NCSL report by Corina Eckl is Legislative Authority Over The Enacted Budget. It replaces the NCSL report (A Legislator's Guide To Budget Oversight After The Appropriations Act Has Passed) that has been the reference work on this subject since its publication in 1983.

Financing Public Schools: For a good summary of the school finance issue, see The State Of Inequality (Educational Testing Service, Princeton, NJ 08541, 1991). The report contains a table contrasting spending levels of the top and bottom spending ten districts in each state. It shows somewhat less disparity than the table contrasting the spending per pupil of the top and bottom districts, which was developed from a 50-state table appearing in Education Week (6/17). Because of special provisions for transportation, school construction, separate categorical programs for certain special students, hold harmless provisions, and other factors, state school aid formulas are complicated. For an explanation of a typical one (which takes 24 pages), see Indiana Fiscal Policy Institute (251 North Illinois St., Indianapolis, IN 46204), A Guide To Indiana School Finance (1992).

Demographics: Gold's assessment, School Enrollment Will Rise In the 1990s, But How Much? was published in April by the Center for the Study of the States (411 State St., Albany, NY 12203) and by State Legislatures (July). The growth rates of population by age were released by the Census Bureau in an April 16 press release. The table comparing enrollment growth reflects the Census Bureau 1990-91 growth rate for the 15 months ending in July 1991 adjusted to an annual rate and the NCES rate as presented by Gold adjusted to an annual rate. The Census Bureau released its new undercount numbers in an August 5 press release. For a broader perspective on use of demographic forecasts in policymaking, see "Should Economists Be Dependent On Official Fertility Projections?" Challenge (July-August).

Medicaid Rates: The data on nursing home rates are from Jane Little's "Public-Private Cost Shifts In Nursing Home Care," New England Economic Review (July/August, 1992). Most of the article is a search for explanations of the large differences among states.

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IN THIS ISSUE

Many observers are looking at how California handled its budget crisis in order to predict actions in other states or prescribe how states should deal with deficits. There may be nothing to learn. California leaders produced different solutions in two successive years. The state's voters haven't yet spoken. And the fiscal problems aren't resolved.

- The Lessons Of California p. 2

California may just be another example of what state officials constantly discover anew — that better-than-average state economic performance can't last forever and that fiscal management is easier in a state outperforming the nation than one underperforming the nation.

- Fiscal Policy In Changing State Economies p. 5

Stagnation in the national economy equals stagnation in the states. In this context, the new Index of State Economic Momentum shows considerable convergence in individual state performance, with losers improving and former high-flyers sinking.

- State Economic Momentum p. 11

New comparisons of per capita income show convergence among states but appear to beg for adjustments to reflect differences in living costs and taxes.

- Comparing Per Capita Income And Living Costs p. 16

Miscellany covers counting population, counting tax increases, higher education, public opinion, university tuition prepayment plans, and what to do when states have no cash. Technical notes detail sources and caveats.

- Miscellany p. 20
- Technical Notes p. 23

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September 1992 (Second Of Two September Issues)

THE LESSONS OF CALIFORNIA?

Introduction

As the dust settled over the September resolution of California's budget crisis, pundits immediately began to offer sweeping generalizations about what it all meant for state policies elsewhere, the mood of the taxpayer, and more. The state's action in rejecting higher taxes has been viewed as indicative of a pattern of resistance to tax increases. Its inability to deal with the issues in a timely basis and its program cuts, particularly in education, have been offered as showing a new pattern of austerity in the states.

California A Trend Setter?

In the occasional attempts to list "innovative" states or states whose policies are often followed later by other states, California is often mentioned. The evidence that California, or any other state, is a trend setter is mixed. For example, California policies on pollution control generally and auto emissions in particular now are playing a leading role in deliberations in other states. The "California standard" has been formally recognized as a goal by many Northeastern governors. However, California's Proposition 103 on insurance regulation was hailed as a trend setter when it was passed, but has only been followed (with major modifications) by a couple of states.

Concerned that "California's adoption of a Draconian budget last week is being seen as an augury for other states," fiscal expert Steven Gold concluded (in an OpEd for the New York Times, 9/8) that California hasn't been a trend setter. Evidence: (1) property-tax cutting Proposition 13 (1978) wasn't closely followed except in **Massachusetts** where property taxes were also high and officials were "arrogant" and "unresponsive," (2) the two-decade long period of avoiding tax increases wasn't matched by other states, and (3) last year's California tax increase, including raising taxes sharply for taxpayers with income more than $200,000, wasn't followed. So Gold argues that California simply demonstrates a more general problem in the states, "that states have more government than they can afford, given the current tax structure and way of providing services."

Gold notes that "California is not the first state to stonewall tax increases, citing **Illinois**, **Massachusetts**, and **Michigan** as other examples. But, he predicts, "Eventually, the balance will probably shift, and their citizens will decide that some increases are preferable to more service cuts." He suggests appropriate state policies include a mix of tax increases, spending cuts, and cost shifts, such as tuition increases.

SPR'S EDITORIAL OFFICE HAS MOVED. See new address and phone on p. 24.

California Problems Aren't Over

It may be premature to learn lessons from California's fiscal policies because the California returns aren't in yet.

Two Years, Two Solutions: With the same governor and legislators, California pursued two quite different fiscal policies in 1991 and 1992 when confronted with what was essentially the same issue, how to deal with an out-of-balance budget. In 1991, state officials took limited actions to control the growth of current service spending and increased taxes substantially. In 1992, they didn't increase taxes but took more decisive action to control current service spending.

Another Year, Another Solution: Neither of these actions, or both together, have solved the fundamental California fiscal problem, which will soon have to be revisited by state officials.

> *It's not a clean vote, but it is a vote that does something to solve the problem.* —Speaker Brown urging votes for the final budget.

Both the 1991 and 1992 actions included many temporary solutions that shifted fiscal problems to subsequent fiscal years. The early September borrowing of over $3 billion to cover operating costs is indicative of the magnitude of the problem that remains. Other actions, similar to some from other states, that shift costs to future years include:

Retirement plans have been tapped in various ways that will increase future costs through early retirement plans and restructuring of benefits.

Tax revenues from future years have been tapped by accelerating collections directly and indirectly by changing the ground rules for resolving disputes with taxpayers to lead to more and faster settlements.

Other funds have been used to supplement the general fund.

Reserves have essentially been eliminated. Summaries of the budget solution reported spending cuts from current service levels of $6.3 billion and revenue increases of $1.7 billion. These total $8 billion, leaving $2.7 billion of the acknowledged gap unaccounted for.

A Deficit in FY 1993 is probably built into the budget because the revenue estimates presume personal income growth that is unlikely to be realized.

As a result, California officials (including some new faces) will consider in 1993 the same issues that current officials dealt with differently in 1991 and 1992. How they will be handled in 1993 isn't obvious from past history.

Voters Have Yet To Speak

California's legislative elections and initiative process will provide a better opportunity for voters to speak on fiscal issues than is presented in most states.

> *We have not overcome the state's financial challenges, but with this budget there is a genuine attempt to move toward a balance of demands for government services and expected revenues.*— California Taxpayers' Association President Larry McCarthy on the new budget.

Anticipating that the legislature wouldn't go as far as he would like in reducing welfare payments and cracking down on spending, Governor Wilson and his allies have a measure on the November ballot that reflects their views. The measure is complex, including some provisions regarding executive and legislative power distribution with which many fiscal conservatives might not concur. It is also a ringing declaration of support for balancing budgets on a timely basis and controlling welfare spending. Voters who concur with the governor on these issues and believe that the Democratic legislative majority was the principal barrier to balanced budgets and appropriate spending restraint will presumably vote for this initiative and for Republicans in legislative elections.

Voters who believe that the state's budget cuts were excessive also can easily express their views. A "Fair Tax" initiative allows them to aim tax increases at corporations and at high income individuals, using part of the revenue raised to cut sales taxes and part to increase state spending. While Democratic legislators aren't campaigning as tax-increase advocates, voters have been subjected to months of news reports describing them as more favorable to taxes and spending than Republicans. So a backlash from spending cuts would be expected to find its way into a strong vote for Democratic legislators.

With these options for expression of voter sentiment and changes in the composition of the 1993 legislature resulting from the 1992 elections, it would seem premature to conclude that California's fiscal orientation is now clear.

It would also be premature to conclude that the elections will make the state's future fiscal orientation clear. There is no requirement that the voters' choices reflect a consistent perspective of lower taxes and spending cuts or higher taxes and fewer cuts. California voters, despite anti-incumbent sentiment, may decide as other voters have that their antipathy to the legislator doesn't apply to their own representatives and simply reelect incumbents. They may reject most of the initiatives, much as they did in the last election with a large number of initiatives on the ballot. They may reflect what the polls consistently show, that they favor lower taxes *and* higher spending. They could, for example, reject measures increasing taxes, reject the governor's measure, and adopt a health insurance mandate for private business that will also be on the November ballot.

FISCAL POLICY IN CHANGING STATE ECONOMIES

Poorly Performing Economy = Fiscal Problems
Old Situation, New State Affected

From a national perspective, much of California's fiscal problem is old news. Like other states, California felt the impact of recession. Unlike most other states, California also felt the impact of loss of economic momentum relative to the nation as a whole. This experience isn't new to the collective experience of state officials, or to the memory of long-time state officials in many states. But Californians have no such experience in their memories and little knowledge of states that have suffered this problem. It arises when a state's economy undergoes a period of nation-leading prosperity.

When The Good Times Roll

Extraordinary prosperity brings an immense demand for new facilities to accommodate the growing population — factories, new homes and neighbors, new public facilities, new restaurants and shopping centers, and more. The money to build these facilities comes, to a significant degree, from outside the economy.

> *California, one has to remember, profited from a generation and more of relentless economic growth. Millions of Americans from other states poured in with their savings, ready to invest. Then California became America's top defense and aerospace state, with vast billions of national taxpayers' wealth flooding into its factories. California could then spend freely without an onerous tax burden.* Neal Peirce column (9/20)

The prosperity feeds upon itself, bringing new citizens to exploit the job opportunities, new retailers and service workers to serve the expanding market, and new homebuilders and office developers to exploit the booming economy. Such an economy generates high levels of employment in business depending on the rapid growth — real estate agents, bankers, lawyers, construction workers, building materials suppliers and more.

The Costs of The Crisis

Observers will never agree on what the 1992 budget crisis cost. The delayed enactment clearly caused extra per diem payments to legislators staying in Sacramento, advertising and overtime associated with issuing "IOUs" to pay state bills, and the loss of savings in FY 1993 resulting from applying them to less than the full fiscal year. But other costs like interest payments from a lower bond rating and interest on the IOUs are more a result of the fiscal problem than from delay in dealing with it.

This prosperity brings wonderful news for state finances. The demographic results are outstanding. The prosperity brings an in-migration of new workers, wage earners and taxpayers who generally don't have school age children and leave their aging parents in other states and countries.

The rapid personal income growth outstrips the willingness of decisionmakers to spend money coupled with non-fiscal constraints on spending such as reaching agreement on facilities, obtaining sites, hiring workers, obtaining federal approvals, and the like. As a result, much of the demand goes unsatisfied or satisfied only by crowding. In California, this has meant crowded schools (pupil-teacher ratios well above the national average) and much publicized highway congestion.

The fiscal result is politically potent. It is the medicine that allowed Governor Dukakis to talk about the "Massachusetts miracle" in 1988. "Taxachusetts" was turned into an average-tax state because tax burdens shrank as a percentage of sharply rising Bay State personal income while other states didn't experience the same prosperity. It is the medicine that allowed states like Texas, Oklahoma, and Colorado to maintain low tax burdens through the early 1980s. It is the medicine that permitted Arizona and Nevada to hold relatively low taxes in the mid-1980s as they drew development from other states. It is why California could live comfortably with the Gann Amendment, a state tax-limiting measure adopted about the time of Proposition 13.

Good Times Don't Roll Forever

Extraordinary prosperity plants the seeds of its own destruction. The young workers drawn to a state have children who grow to school age. The retired population increases as the earlier migrants age. Land values and housing prices rise to extreme levels as demand outstrips supply. Wages tend to grow well above wages in competing states. Congestion becomes a problem. These factors alone would tend to prevent a state from leading national averages forever. The correction, with no outside causes, can be painful as indicated by the economic and fiscal history of Arizona during the 1980s.

> *The budget we have just signed is a very difficult budget. It is not only difficult in terms of getting it to my desk, but it is a difficult budget in that it reflects the very trying times we are experiencing, the worst economic times since the Great Depression.* —Governor Wilson signing the budget.

When the tendency of an overheated economy to unwind by itself is coupled with shocks from outside, the economic situation turns around quickly. This happened to New England states in the late 1980s, to the Oil Patch states in the mid-1980s, and to Michigan in the 1970s.

It now appears to be happening in California. The remarks of the Finance Department's chief economist to a business symposium in September describe the problem:

> *The normal sequence of economic activity that creates prosperity has turned into a vicious, underperforming cycle. Spending for consumer goods and housing depends on income and confidence which depends on job growth that depends on business confidence and business expansion which depends on the housing and consumer market. I'm not sure how we break the loop.*

August estimates show that the California unemployment rate jumped to 9.8% from 8.9% in July. The national rate was 7.6%, down slightly from 7.7% in July. California's rate was well above that of other large states. The Finance Department economist commented, "It still appears California is heading south."

> *This is a year in which we are downscaling and downsizing everything.* —Speaker Brown on the FY 1993 budget.

The pattern in other states suffering decline was to underestimate the magnitude of the resulting state fiscal problem and then to spread fiscal adjustments, both higher taxes and restraints on spending growth, over a long period. California may just be repeating this pattern. If it is, there are no implications for other states.

California Learning To Live With Slow Growth?

If California's adjustments are comparable to those of other states with similar problems, its adjustments will lag behind the evolving reality of its economy. As personal income growth lags the national growth rate, **the percentage of personal income taken as taxes will tend to rise**.

> *The people have to come to grips with the fact that what we have is a squealing pig and the tighter we squeeze it, the louder it will squeal.* Richard Gann on those who contend budget cuts hurt California.

This transition isn't automatic. It requires tax increases, like those California enacted in 1991, or substitutes for tax increases such as the many charges levied by California local governments to avoid Proposition 13's limits on property tax increases. It also requires some deviation from the Gann Amendment's limits on the growth of state taxes and spending. California voters have already approved one such deviation in the name of better highways. They may be asked to approve a second one in the name of maintaining other state services.

But if national patterns are followed, **the increases in government spending will drop below what California now defines as current services**. This tendency can be seen in the actions taken in 1991 and especially in 1992. California abandoned its tradition (and law) of automatic cost-of-living increases for welfare recipients. Whether the further cuts going before voters in November are accepted or rejected, California isn't likely to restore automatic cost of living increases.

By moving to higher tuition, California has shifted some of the costs of government to students, as is fully recognized. Less recognized is that California will be reducing the cost of government by its tuition increases and by more limited course offerings and fewer campuses than envisioned in its higher education master plan. More students are probably on waiting lists, as community college leaders claim, but also the demand for higher education is bound to drop as the price rises. Medicaid costs will be reduced from current service levels by tighter approaches to eligibility for cash assistance, lower assistance payments, and eventually more serious constraints on services. California public employee compensation, well above the national average, is already being restrained by the fiscal circumstances of state government and by shifting cost pressures to local schools.

> *We had an $11 billion hole to fill, and we were compelled to do things that no one wanted to do.* —Governor Wilson on the budget.

Governor Wilson and his predecessor placed great emphasis on a structural imbalance in the California budget. Cost cutting measures will, no doubt, further reduce the imbalance, though not without a fight. How long the state will face a fiscal situation more severe than the average state depends on how effective this effort is, as well as on how the state's economy performs. New York is suggestive of how long the situation can persist.

New York doesn't have tax burdens that are 30% to 50% above the national average because decision makers decided that result was appropriate policy. The state maintained relatively normal tax burdens, in relation to personal income or other measures of taxpaying capacity, in the days when its per capita public spending exceeded the national average by about as much as its per capita personal income. For decades now, it has been more difficult for the state to expand spending than most states because of generally slower personal income growth.

Governor Wilson and the California Finance Department discuss the long-term problem in terms of a "dependency ratio," the relationship between the size of the working age group (ages 18-64) and the number of other residents. They expect the dependency ratio to increase in California between 1990 and 2000 while it is dropping nationally. The result, according to the Finance Director:

> *Because other states will not experience the same explosive growth in the demand for government services and payments as California, the state will be at a competitive disadvantage if it raises taxes in order to meet increased demands. Tax increases may well encourage some working-age Californians to leave the state, further exacerbating the budget problem. Indeed, there is evidence that this may already be occurring.*

Crisis Budgeting

If the assessment in this article is correct, then California's actions this year, and last year, are steps on the road of adjustment that is by no means yet fully traveled. If California follows the patterns of other states, the adjustment won't be decisive in any one year. So long as there is the hope, as there will likely be every year, that the state's economic problem is temporary, there will never be consensus on either the downsizing that would be required to live without tax increases or on the tax increases that would be required to live without cutting current service spending. So one crisis may be followed by another. California's Treasurer warned in an OpEd in the Sacramento Bee (8/20):

> *Unfortunately, this crisis may just be a preview of things to come. While all eyes have been glued to budget deliberations in the Capitol, the state is also in the grips of a cash crisis that could linger far after a budget deal is struck. Because of the six-week budget delay, the lack of a "rainy day" reserve fund and the continued sluggishness of the state economy, we run the risk that the state will be unable to make ends meet through the entire fiscal year. Come spring, California could once again experience the disgrace of IOUs.*

The Impacts Of Retrenchment

California's downsizing is most severe in the areas where state spending has greatly exceeded national averages. In a national climate of freezes and inflation-level increases, California's cuts below prior year levels will appear Draconian. Those adjustments in 1992 were most apparent in cash AFDC payments, state supplements of federal Supplemental Security Income payments (to the aged, blind, and disabled), and higher education.

One view of the budget was that public higher education would get $500 million less funding than in FY 1992, but would collect $241 million more money from students. The estimate of enrollment demand that wouldn't be met — because students would be driven out by enrollment caps, reduced aid for students who already receive it and no money for new students, closed classes, and higher tuition — was 160,000 to 250,000 students. The executive director of the higher education coordinating commission commented:

> *Clearly, we need new strategies for higher education in California in the 1990s. We expect continuing financial problems and access problems, even after the state economy recovers.*

The retrenchment will affect all levels of California government. Local governments have problems of their own associated with less tax base growth than usual and the growing demands for locally provided services, particularly the local components of health and social services. The state budget shifts a part of the state's fiscal problem to local governments, though state and local officials dispute how much. One mechanism effectively shifted some of the property tax base of other local governments to school districts.

Los Angeles Mayor Bradley has indicated that he doesn't expect to seek reelection. The Superintendent of Los Angeles schools recently resigned. The school district, which serves about 650,000 students, is dealing with what its officials describe as a 10% cut. One proposal was pay cuts of as much as 16% for some workers. Los Angeles County is discussing cuts which its officials describe as reducing its budget by about 17%.

Time Heals The Wounds

The good news for California is similar to the good news that developed in other states for similar reasons. Out of adversity comes a stronger, though downsized, economy. That economy will have more well-trained workers available, lower wages, lower housing prices, and eventually less price pressure throughout the economy. With less economic opportunity to attract immigrants, migration to the state will tend to slow, relieving some of the pressures on public services. In the painful process, confidence will drop, speculative building will largely disappear, and the state could suffer a recession equivalent to that faced by New England states through much of the 1960s and 1970s. Eventually, a resurgence is likely to develop, as it did in New England and in the Oil Patch states.

California is attempting to discourage immigration to take advantage of its generous welfare and health benefits. One measure, which requires federal waivers, limits the AFDC payment to new residents to what they could have received in their previous state of residence. This lower level would continue for a year. There is also an effort to eliminate health benefits for undocumented aliens except for clear emergency situations.

Economic adversity will probably cause changes in the environment for business, as it has in other states. For example, Northeastern states such as **Pennsylvania** made major adjustments in state policies in the 1960s and 1970s. These included more aggressive industrial recruiting, new subsidies for plants exceeding competitor's abatements, and a significant reduction in the corporate income tax rate. The governor is targeting what he calls "made-in-California problems, self-inflicted wounds." One example was the Workers Compensation reform package which nearly was enacted in this year's legislative session.

State Elected Officials Not Popular

The California budget and the lengthy process by which it was developed didn't draw high marks from voters. A Field Poll taken in September showed that 53% of voters disapproved of the new budget, with 33% approving and 14% expressing no opinion. Respondents gave low marks to all the participants for their performance during the budget deadlock, as shown in the table.

Voter Perception of California Elected Officials' Performance In 1992 Budget Crisis

Elected Officials	Excellent/ Good	Fair	Poor/ Very Poor	No Opinion
Governor (R)	19%	23%	47%	11%
House Speaker (D)	16	23	39	22
Senate President (D)	10	28	25	37
House Democrats	11	33	35	21
House Republicans	11	31	34	24
Senate Democrats	13	30	33	24
Senate Republicans	12	31	32	25

While the table can be searched for nuances of opinion, the overwhelming message is that none of the participants' performances ware perceived favorably.

STATE ECONOMIC MOMENTUM

Major Differences In State Economic Performance

The quarterly Index of State Economic Momentum is designed to measure the performance of state economies with a single statistic. The Index sets the national average at 0%, which reflects personal income growth of 4.1%, employment loss of 0.51%, and population growth of about 0.8%. A state matches the average by matching all three components, or by any combination of deviations from them that cancel each other.

The rankings, like those of the Index published in June (Issue 12), show prosperity relative to the nation as a whole concentrated in the Northwest and West. The bottom ranks are dominated by Northeastern states. The latest Index numbers and the components of personal income and employment, shown in the sections below, show significant changes in economic leadership among the states. The changes reflect success in economic development and cause significant differences in fiscal challenges facing individual states.

Index Of State Economic Momentum, September 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	2.61%	18	Hawaii	0.64%	34	West Virginia	-0.12%
2	Idaho	2.22	19	Mississippi	0.59	35	Illinois	-0.26
3	Utah	1.70	20	North Dakota	0.58	36	California	-0.37
4	Oregon	1.52	21	Alaska	0.57	37	Ohio	-0.38
5	Arkansas	1.48	22	Tennessee	0.41	38	Virginia	-0.42
6	Washington	1.40	23	Nebraska	0.40	39	Maine	-0.51
7	Texas	1.36	24	Georgia	0.40	40	Vermont	-0.62
8	Montana	1.24	25	Michigan	0.40	41	Pennsylvania	-0.72
9	Kansas	1.21	26	Florida	0.31	42	South Carolina	-0.77
10	South Dakota	1.12	27	Alabama	0.29	43	Delaware	-1.02
11	Colorado	1.10	28	Iowa	0.22	44	New York	-1.03
12	Wisconsin	1.02	29	Missouri	0.11	45	New Hampshire	-1.04
13	Kentucky	1.00	30	Arizona	0.08	46	Maryland	-1.05
14	North-Carolina	0.89	31	Louisiana	0.07	47	Massachusetts	-1.35
15	Indiana	0.86	32	Wyoming	0.03	48	New Jersey	-1.45
16	Minnesota	0.79		**United States**	**0.00**	49	Connecticut	-1.82
17	New Mexico	0.74	33	Oklahoma	-0.07	50	Rhode Island	-1.87

Stagnation In The Northeast: Although still in the bottom third, several New England states have broken away from the bottom and the differentials between New England states and the national average has narrowed from a year ago. Both facts suggest a bottoming out of the area's recession. However, serious fiscal problems remain despite tax increases in **Connecticut** and **Rhode Island** and spending restraint throughout the region. **Massachusetts** revenues are above estimates and it has improved its bond rating. **Maine** and **Vermont** expect serious budget problems next year. The problems in **New Hampshire** are so serious that adopting a sales or income tax is being considered seriously.

Farther down the Atlantic Coast, the situation isn't getting better. Despite large tax increases this year, **Maryland** officials are debating whether their FY 1993 shortfall is more like $250 million or $500 million. Conditions in **Florida** are the worst in years, but the **Georgia** economy is OK.

More Problems In The Far West: Besides slowness in **California** and **Hawaii**, there are signs that **Washington**'s boom is slowing. **Nevada** should drop from its #1 rank when new population estimates are released this winter.

Strength In The Midsection: From **Idaho** and **Colorado** to **Wisconsin**, continuing down to **Texas**, states are outperforming the national economy. This hasn't eliminated fiscal problems, but has alleviated some of them.

Employment Picture Mixed

From June of 1991 to June of 1992, the economy lost about 555,000 jobs or about half of a percent of all jobs. The distribution of job changes was highly skewed. Gains were experienced in 28 states, led by **Texas** (which gained 75,800 jobs), **Indiana** (36.500), and **Wisconsin**, (34,300).

Losses were more concentrated, with 14 states having losses of 10,000 or more jobs. The big losers were **California** (228,900), **New York** (182,600), and **New Jersey** (97,300). The table shows the percentage changes.

Percent Change In Employment, June 1991 To June 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arkansas	2.96%	18	Alaska	0.71%	34	Florida	-0.59%
2	Utah	2.45	19	Washington	0.71	35	Oklahoma	-0.62
3	Idaho	2.40	20	Wyoming	0.70	36	Ohio	-0.65
4	Kansas	2.19	21	North Carolina	0.57	37	Virginia	-0.72
5	Montana	1.90	22	Nebraska	0.57	38	Maine	-0.74
6	North Dakota	1.68	23	Hawaii	0.48	39	Pennsylvania	-1.34
7	Nevada	1.65	24	Mississippi	0.37	40	Delaware	-1.63
8	South Dakota	1.64	25	Alabama	0.13	41	New Hampshire	-1.73
9	Wisconsin	1.48	26	Iowa	0.08	42	South Carolina	-1.73
10	Indiana	1.45	27	Louisiana	0.02	43	Vermont	-1.80
11	Colorado	1.39	28	Georgia	0.01	44	California	-1.82
12	Oregon	1.27	29	Arizona	-0.09	45	New York	-2.28
13	Texas	1.05	30	Tennessee	-0.10	46	Massachusetts	-2.31
14	West Virginia	0.96	31	Michigan	-0.12	47	Rhode Island	-2.45
15	Minnesota	0.96	32	Missouri	-0.13	48	Maryland	-2.55
16	Kentucky	0.93	33	Illinois	-0.50	49	New Jersey	-2.74
17	New Mexico	0.73		**United States**	**-0.51**	50	Connecticut	-3.44

In the unsatisfactory economic climate of the past year, any job gain was a good sign. But judged against more normal job growth of 1%, less than a fourth of the states showed significant growth in employment. With the exception of **Oregon**, the leading states are in the center of the country. The late 1980s talk of a "bicoastal economy" is clearly dead. States on the Atlantic Coast and **California** turned in the worst percentage performance. The large states of the South and Midwest — like **Georgia**, **Illinois**, and **Michigan** — are concentrated close to the national average.

Personal Income Growth Slow

Personal income in the first quarter of 1992 was 4.1% ahead of personal income one year earlier. With inflation running about 3%, real personal income growth about matched population growth of about 1%. The state statistics appear in the table.

Percentage Change In Personal Income, First Quarter 1991-1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Idaho	7.3%	18	Wisconsin	5.2%	34	Ohio	3.7%
2	Montana	6.3	19	New Mexico	5.1	35	Arizona	3.5
3	Texas	6.3	20	Indiana	4.9	36	Florida	3.5
4	Kentucky	6.2	21	Minnesota	4.9	37	New York	3.4
5	South Dakota	6.2	22	Oklahoma	4.9	38	Pennsylvania	3.4
6	Utah	6.0	23	Alabama	4.8	39	Vermont	3.4
7	Mississippi	5.8	24	Alaska	4.8	40	California	3.2
8	Oregon	5.8	25	Nebraska	4.8	41	Maine	2.9
9	Colorado	5.7	26	Nevada	4.8	42	South Carolina	2.9
10	Arkansas	5.6	27	Iowa	4.7	43	New Jersey	2.7
11	Kansas	5.6	28	Hawaii	4.6	44	Virginia	2.7
12	North Dakota	5.5	29	Wyoming	4.6	45	Maryland	2.6
13	North Carolina	5.4	30	Georgia	4.5	46	Massachusetts	2.6
14	Louisiana	5.3	31	Missouri	4.4	47	New Hampshire	2.6
15	Washington	5.3		**United States**	**4.1**	48	Connecticut	2.2
16	Michigan	5.2	32	Illinois	3.9	49	Delaware	1.7
17	Tennessee	5.2	33	West Virginia	3.8	50	Rhode Island	1.0

An Alternative Measure Of State Economic Performance

The Index of State Economic Momentum has spawned several similar indices in the years since it was introduced. The latest appeared in U.S. News (9/14). It is much more volatile than **Report**'s index because it includes housing prices and business bankruptcy rates. It also treats population growth differently. It indirectly, and probably inadvertently, treats population growth as an negative indicator by using per capita income growth and the unemployment rate as positive indicators. When discouraged potential workers leave a state and out-of-state university students never come back, the population loss reduces the denominator of per capita income and the unemployment numerator.

As a result, states like **Idaho**, **Utah**, and **Washington** have substantially lower ranks in the U.S. News index. It ranks **Hawaii** last, followed (in reverse order) by **New Jersey**, **California**, **New York**, **Delaware**, and **Nevada**. The magazine ranks **Oklahoma** first, followed by **Kentucky**, **Arkansas**, **Kansas**, and **South Dakota**.

Growth Policy And Economic Circumstances

The Index of State Economic Momentum is a good indicator of how serious state officials are likely to be about "growth policy." When state economies are booming, concerns grow over the adverse effects of growth — pollution, congestion, increasing demands on public services, rising infrastructure costs, and a fear that the old charm is being lost. Such concerns have been a major factor in **California** politics for decades. Now they are of particular concern in fast-growing states like **Washington**. But some of the policies in California are under attack as discouraging economic development.

Growth management was a major theme of Jerry Brown when he was the Golden State's governor. Subsequent governors and many legislators have had an interest in the issue. Governor Wilson, who had made part of his reputation on growth management planning as mayor of San Diego, expected to carry the theme into his administration. His interest lead to development of a growth management proposal and public discussion of it. Late last year the governor opted not to push it. As one official put it, "It would be strange to come out with a growth management program when there's no growth to manage."

Business-Oriented Tax Cuts

Concern with promoting growth, not controlling it, tends to be strongest in the states suffering the most economic adversity. **Massachusetts** provides an example. This year, Governor Weld (R) discouraged renewing a temporary increase in the income tax, so the tax was automatically reduced. He also proposed a further income tax cut, but the idea was rejected by the legislature. His new legislative proposals take a different approach. Proposed reductions will be concentrated on business: (1) the business tax credits (job expansion, investment) proposed last year but rejected by the legislature and (2) a capital gains cut. Personal income tax reduction isn't in the package. The governor told reporters:

> *With the fiscal crisis behind us, we really should let nothing interfere with job creation. My economic development plan will be targeted at that sole objective.*

The governor is also seeking direct state aid to capital-starved firms, an industrial policy of sorts. The Weld Administration is describing its plan as "rifle-shot type approaches." The Speaker (D) has expressed doubt about further tax cuts. He argues that the budget has "no wiggle room at all."

There is also an unusual moratorium on debate in Massachusetts over the November ballot initiative to require corporations to reveal how much they pay in state taxes. State leaders are looking for a compromise to cut off a debate they believe is souring business on their state.

COMPARING PER CAPITA INCOME AND LIVING COSTS

Per Capita Income: Most statistics used to measure state economic growth deal with income, jobs, and total production growth, unadjusted for population. For cross-state comparisons of the economic situation of residents, per capita comparisons are more appropriate. The most recent per capita income data appear in the table.

Per Capita Income, 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$26,022	18	Minnesota	$19,125	34	North Carolina	$16,853
2	New Jersey	25,666		**United States**	**19,092**	35	Arizona	16,579
3	Massachusetts	23,003	19	Florida	18,992	36	Tennessee	16,486
4	New York	22,471	20	Michigan	18,655	37	South Dakota	16,071
5	Maryland	22,189	21	Kansas	18,322	38	Montana	15,675
6	New Hampshire	21,760	22	Vermont	17,997	39	Kentucky	15,626
7	Hawaii	21,190	23	Wisconsin	17,939	40	North Dakota	15,605
8	Alaska	21,067	24	Missouri	17,928	41	Oklahoma	15,541
9	California	20,847	25	Ohio	17,770	42	Alabama	15,518
10	Delaware	20,816	26	Nebraska	17,718	43	South Carolina	15,467
11	Illinois	20,731	27	Oregon	17,575	44	Idaho	15,333
12	Virginia	20,082	28	Maine	17,454	45	Louisiana	15,046
13	Nevada	19,783	29	Georgia	17,436	46	New Mexico	14,644
14	Washington	19,484	30	Iowa	17,296	47	Arkansas	14,629
15	Colorado	19,358	31	Texas	17,230	48	Utah	14,625
16	Pennsylvania	19,306	32	Indiana	17,179	49	West Virginia	14,301
17	Rhode Island	19,207	33	Wyoming	16,937	50	Mississippi	13,328

As they have for years, these statistics show that states in the Northeast are the most affluent, with **Connecticut** and **New Jersey** leading the nation. Southeastern states have consistently been lowest. However, states outside the region like **Idaho**, **New Mexico**, and **Utah** also appear in the bottom ranks.

Changes In Per Capita Income: The 1991 data show a strong tendency for per capita income differentials among states to narrow. Per capita income of the six least affluent states grew by better than 4% from 1990 to 1991, well above the national average growth of 2.4%. Of the 18 poorest states, all but **Idaho** had per capita income growth above the national average. The five top states in per capita income each had per capita income growth below the national average. Viewed another way, the top nine states in per capita income growth all have per capita incomes below $16,000, well below the national average of just over $19,000.

The one-year changes in per capita income are shown in the table. The leaders are Western and Southern states. The laggards are some previously high-growth states including **Alaska**, **California**, and **Nevada**.

Percentage Change In Per Capita Income, 1990-1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Montana	7.00%	18	Kansas	3.14%	34	Massachusetts	2.14%
2	Louisiana	5.37	19	Pennsylvania	3.14	35	New Jersey	2.02
3	Mississippi	4.87	20	Hawaii	3.10	36	Ohio	2.02
4	Arkansas	4.43	21	Wyoming	3.03	37	Michigan	1.98
5	Kentucky	4.42	22	Nebraska	2.88	38	Connecticut	1.95
6	West Virginia	4.36	23	Oregon	2.79	39	Florida	1.93
7	Alabama	4.29	24	North Carolina	2.77	40	Illinois	1.93
8	New Mexico	4.21	25	Wisconsin	2.70	41	New York	1.90
9	Utah	4.21	26	Oklahoma	2.66	42	Vermont	1.87
10	Washington	4.04	27	Arizona	2.62	43	Maine	1.85
11	Texas	3.92	28	South Carolina	2.45	44	Virginia	1.81
12	Tennessee	3.82	29	Iowa	2.44	45	Maryland	1.71
13	New Hampshire	3.63		**United States**	**2.43**	46	Idaho	1.55
14	South Dakota	3.52	30	Georgia	2.42	47	Delaware	1.47
15	Missouri	3.49	31	Minnesota	2.33	48	Alaska	1.46
16	North Dakota	3.22	32	Indiana	2.30	49	California	1.27
17	Colorado	3.20	33	Rhode Island	2.24	50	Nevada	0.54

Unusual population changes cause the per capita income growth comparisons to differ from economic growth comparisons unadjusted for population change. Rapid population growth reduces per capita income growth in states like **California**, **Idaho**, and **Nevada**. States like **West Virginia** can show more rapid per capita income growth because they are experiencing little population growth.

Cost Of Living Adjustments: There is a persistent demand for factors that can be used to adjust comparisons of per capita income, teacher salaries, and other information to reflect differences in cost of living among the states. For many good reasons (simply stated: no generally acceptable conceptual base, insufficient data to go with any base, differences within states often more important than differences among states), there is no generally accepted method for making such comparisons.

A modest attempt to make adjustments was recently developed by the Finance Department in Arkansas. It uses data from the 1990 Census to adjust for differences in housing costs and data on government revenues by source to make a partial adjustment for differences in taxes:

As might be expected from the methodology, the adjustments tend to improve the relative median incomes of poorer states and lessen the advantage of richer states. For example, upward adjustments of 15% or more would be made for **Alabama**, **Arkansas**, **Mississippi**, and **West Virginia**. Downward adjustments over 7% would be made in **California** (8.8%), **Connecticut** (9.3%), **Hawaii** (11.5%), **Massachusetts** (8.7%), **New Jersey** (9%), and **New York** (8.5%).

Adjustments For Taxes: The tax adjustment shows why there are substantial differences of opinion about the validity of using such adjustments in relating living standards or salaries of individual living in different states. Selecting which taxes to count in adjustments is a problem, conceded in the study. The data on some "individual" taxes include "business" taxes like sales taxes on business-to-business sales. The data exclude some taxes, such as selective excise taxes, that represent important tax burdens on individuals in some states. There are also important conceptual issues associated with adjustments. For example, how much of a state's corporate income and business personal property taxes should be considered as being shifted to in-state employees?

Even if the data were perfect, there is a problem. In FY 1989, the study finds New York imposed per capita individual taxes of $2,427 while Arkansas imposed taxes of $877. This difference is used to adjust the purchasing power of the portion of personal income associated with taxes (about 10%), giving Arkansas an adjustment factor of 62% of the national average and New York a factor of 171%. One problem is that the data are simply showing that the average New Yorker has more income than the average Arkansan, so the average New Yorker pays more tax per capita. *Such differences could exist even though persons with identical incomes in the two states had identical tax burdens.*

Differences in taxes can reflect differences in services. For example, part of the New York differential pays for smaller classes. The tax adjustment may reflect that differences and others, such as subsidized mass transit that is a major factor in lives of many New Yorkers but few Arkansans. If applied to adjust teacher salaries, the adjustment could be misleading for another reason. Even if Arkansas and New York had identical teacher salary schedules, the tax bill for Arkansas teachers would be less because: the average Arkansas teacher would fail below the average New York teacher on the schedule. In New York (with little enrollment growth), the average teacher would be older (and thus have more experience counted in determining salary) than the average Arkansas teacher.

Adjustments For Housing: The housing adjustment uses data that readers may find useful for some purposes. The 1990 Census data permit comparing states on the basis of median rents, median value of owned homes, and percentage of the population of each state that lives in homes they own. These data, presented in the Arkansas report, are combined to produce an adjustment factor for the portion of household income associated with housing costs (about 15%).

The variations in housing costs are large. Median monthly rents in 1989 varied from a high of $599 in Hawaii to a low of $215 in Mississippi. Median values of owner-occupied houses varied from $245,300 in Hawaii to $45,200 in South Dakota. The housing adjustment factors are shown in the table.

State Median Housing Costs As Percentage Of U.S. Average, 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	241%	18	Florida	101%	34	Wyoming	76%
2	California	204	19	Illinois	101	35	Tennessee	74
3	Connecticut	194	20	Arizona	100	36	Idaho	72
4	New Jersey	182		**United States**	**100**	37	Louisiana	72
5	Massachusetts	177	21	Minnesota	96	38	Indiana	71
6	New Hampshire	152	22	Georgia	91	39	Montana	70
7	Rhode Island	145	23	Pennsylvania	88	40	Kansas	69
8	New York	142	24	New Mexico	87	41	Nebraska	68
9	Maryland	140	25	Oregon	87	42	North Dakota	67
10	Alaska	126	26	Utah	85	43	Alabama	66
11	Delaware	123	27	Wisconsin	82	44	Kentucky	65
12	Nevada	120	28	Michigan	81	45	Oklahoma	64
13	Vermont	115	29	North Carolina	81	46	Iowa	62
14	Virginia	113	30	Ohio	80	47	South Dakota	60
15	Washington	112	31	Texas	80	48	West Virginia	60
16	Maine	106	32	Missouri	76	49	Arkansas	59
17	Colorado	102	33	South Carolina	76	50	Mississippi	58

The differences shown on the table are massive. Four states are 40% or more below the national average and 15 states are more than 25% below average. **Hawaii**'s costs are more than 2.4 times the national average. **California**'s are twice the national average. Nine states are 40% or more above average. Part of the difference has an obvious cause. In 1989, residents of **Connecticut**, **California**, and **Hawaii**, on average, had much more money to spend than residents of **Arkansas**, **Mississippi**, and **West Virginia**. Not surprisingly, they opted to spend some of their income advantage on housing. This difference doesn't mean that *the same house* was more expensive in one of these states than another, just that *the average house* was more expensive.

Problems With The Adjustments: Adjustments of household income and especially public and private salaries on the basis of these averages doesn't make conceptual sense. For example, consider a starting teacher looking for work. If the teacher is expecting to rent a newly constructed two bedroom apartment, the cost differentials will be much smaller than these averages.

Large components of the cost of such a residence will be determined by interest rates (basically national), costs of lumber and appliances (uniform except for transportation cost differences), and construction wage rates (which differ much less than the differences shown in average housing costs). Furthermore, there is considerable variation within states. If the teacher is considering employment in the suburbs of Little Rock or Jackson, he or she may find housing more expensive than if considering employment in Upstate New York or Northern California.

Another important factor in housing cost comparisons, including the median prices reported in the press as well as those in the Census data, is their variability in relation to short and medium term economic changes. The stock of housing responds slowly to changes in demand, so current prices will deviate substantially from the costs of land and new construction in many situations. When demand expands rapidly, as it did in **California** and **Hawaii** in the 1980s, prices tend to be bid up. When the owner's alternative to sale at a low price or renting at low rates is letting a unit stand empty, sales prices and rents tend to drop as happened in the 1980s throughout **West Virginia** and in rural areas in the South and farm Midwest.

When the economic circumstances change, housing prices tend to move closer to the costs of new construction. As a result, there has been a substantial decline in housing costs in the New England states in the years since 1989, significant declines in some areas of **California** recently, and a real possibility that **Hawaii**'s recent economic slowdown will soon translate into higher housing costs. The reverse is true in states that have experienced more growth, notably **Oregon** and **Washington**, as well as some of the Southeastern states that have been experiencing steady growth.

MISCELLANY

Counting Population

The Census Bureau's decision on which 1990 population estimates to use to estimate state populations in the 1990s (Issue 17) has been postponed until after the November elections. The Bureau will now accept public comments through mid-November and make a decision after the end of the comment period. The choice remains whether to start the year-by-year estimates from the 1990 Census official count or from 1990 estimates corrected for "undercounts," which would add much more population in Sunbelt states than elsewhere.

Counting Tax Increases

Sharply conflicting estimates used in the Presidential campaign of how often Arkansas raised taxes while Governor Clinton was in office underline the imprecision of tax increase calculations. President Bush used about 130 increases while at the same convention Governor Engler used a number half that size. The Arkansas Department of Finance and Administration has developed a tabulation of 127 increases of which 34 were tax increases and the rest fees, but it points 73 tax cuts as well. The President's research was based on an annual tax handbook published by the Arkansas legislature. The larger counts include fee increases such as those relating to court costs and fees for reproduction of birth certificates. One count includes increased revenue associated with lengthening the dog racing season. There are similar problems in counting Bush tax increases, such as whether to count the revenue measures in the 1980 budget agreement as one tax increase or 30.

In attempting to sort out who was correct, some journalists began offering their own interpretation of what constitutes a tax increase. For example, the Boston Globe (8/28) described "the common definition, one involving broad-based levies that increase the amount most people must pay." By that definition, cigarette tax increases which are paid by a minority of the population wouldn't be counted as tax increases though they are counted by all scorekeepers of tax increases.

The definition problems will be particularly noticeable this year as national comparisons are issued from various sources. NCSL counts renewals of temporary taxes and health provider taxes in at least some states as increases. SB&TN and the Center for the Study of the States ignore renewals but SB&TN counts provider taxes while the Center and the Census Bureau don't.

Higher Education Gets The Message

The University of California budget was probably cut more than it would have been had it not been voted upon at the same time UC was embroiled in controversy over excessive spending on executive pay and perquisites. Legislators and the press clearly didn't buy the argument that having some of these expenses paid out of foundation money made them less real or relevant. In early September, UC's president announced elimination of regular use of first class air travel, reimbursement for business meals with other university employees except where a clear business purpose was documented, and purchases for personal use such as wedding gifts and personal clothing. Critics suggested it was too little, too late.

Public Opinion

A recent Wall Street Journal/NBC News poll (WSJ, 9/18/92) suggests that voters, who often have fierce objections to proposed tax increases, are relatively uninterested in lowering the current level of taxes. Though the poll asked about federal policy, the attitudes presumably apply to state taxes as well. A large sample of voters was asked, "If there were a choice on the best way to use $25 billion of federal funds, which approach would you favor?" The three options presented and the percentages favoring each were: (1) "invest in job training, education, and transportation, 56%, (2) "reduce the deficit," 31%, and (3) "an across-the-board tax cut," 10%.

The same voters were asked to identify which of six listed economic issues they considered most important. Unemployment drew nearly a 50% response, followed by the federal deficit (about 25%), and the trade deficit, inflation, federal taxes, and interest rates — all with less than 10%.

University Tuition Prepayment Plans

Led by Michigan, some states have established special savings plans designed to allow parents, grandparents, and others to put aside savings with a guarantee that they will cover in-state tuition costs when a child is ready to enter college. The plans have been popular in many of the states that have adopted them. For example, **Florida** has about 150,000 contracts in effect. These plans have run into several difficulties.

The plans set the costs of guarantees based on: (1) the number years between contributions and when a child would enter college, (2) the interest the state expects to earn on investment of the contributed funds, and (3) the rate of increase in university tuition. The plans were established when the expected increases in state university tuition were, as they had been, reasonably close to the inflation rate. This assumption is proving incorrect in the many states that have translated fiscal problems into much more rapid tuition increases. The assumed interest rates when plans were established were generally much higher than current interest rates. As a result, the amounts that need to be contributed must rise. **Florida**, for example, recently announced an increase of 13%, raising the cost for a guarantee for a newborn child to $5,150 for a contract good for four years at a state university.

The initial **Michigan** plan also presumed a favorable ruling from the IRS on federal tax treatment of the interest earnings. The tax issues are complex and decisions may be subject to change. At the moment the federal tax treatment is less favorable than presumed when the plan was adopted. As the case stands under a federal district court decision in July, the buyers of the tuition contracts won't have interest income imputed to them, but the state's trust itself isn't tax-exempt.

Anticipation of these difficulties were one of the reasons why opposition to the plans developed in many states. However, if the plans are set up so that each new year of contracts has prices based on then current assumptions, there is no inherent reason why the plans aren't feasible. Obviously, as the costs of the contracts rise, the demand for them is likely to be reduced.

When States Run Out Of Cash

California's widely publicized use of registered warrants (IOUs) to pay bills ended as budget approval cleared the way for over $3 billion in short term borrowing. Over $3 billion of the IOUs were issued in FY 1993 while the budget remained under consideration in the legislature. They are now being redeemed quickly. As the controller indicated in announcing his staff would work around the clock to clear back obligations, "I want this embarrassing chapter of California history behind us as quickly and smoothly as possible."

Although there is already talk of using the IOUs again, they are unlikely to be copied by other states as a substitute for short-term borrowing or simply delaying payment of tax refunds and vendor payments. With interest of 5%, the IOUs were more expensive than short term borrowing, as indicated by the 3.5% interest rate on the California notes. They also cause higher administrative costs, as interest must be calculated and paid on a large number of small obligations rather than one large one. They created considerable inconvenience for the public, particular through most of August when some major banks weren't accepting them, requiring the state to move to back-up measures such as accepting them for money owed the state. They unquestionably created much more negative publicity for California than other states with similar cash problems (e.g., **Illinois**) incurred by using less novel devices.

TECHNICAL NOTES

California: The assessment of California's dependency ratio is summarized in NCSL's Fiscal Letter (July/August) in an article by Finance Director Thomas Hayes. The Field Poll was reported in the Sacramento Bee (9/16).

Index Of Economic Momentum: The index is the average of the differences between each state's one-year change and the national change in (1) population, (2) personal income, and (3) employment. The measure shows how each state's economy is performing in relation to the nation and the other 49 states. Employment data are from the Bureau of Labor Statistics. Personal income and population data come from the Department of Commerce. The population change is from mid-1990 to mid-1991. The employment and income components are shown in separate table in the article.

Personal Income: The personal income data are estimates from the U.S. Department of Commerce, based on independent estimates of total personal income and of population. Links of income and family characteristics are based on individual household surveys, particularly the Census of Population. It was last taken in 1990, with information from a large sample of households on economic circumstances during 1989.

The data on adjustments for housing costs and taxes discussed in the text are based on an analysis of these data by Lawrence Santi issued in Arkansas Fiscal Notes in July (published by his employer, the Arkansas Department of Finance and Administration, Economic Analysis and Tax Research, P. O. Box 3278, Little Rock, AR 72203) and as a separate paper ("Household Income In The United States") in August. For a more elaborate attempt to adjust for cost of living differences see, Herman B. Leonard, By Choice Or By Chance?: Tracking The Values In Massachusetts Public Spending (Pioneer Institute, 21 Custom House St., Boston, MA 02110, 1992).

Besides the material covered in the article in this issue, Santi's paper includes a comparison of inflation-adjusted median household income growth from 1979 to 1989. The data have limitations. State comparisons are affected by changes in average household size which undoubtedly haven't affected all states equally and by use of a nationally uniform inflation factor, even though inflation may not have affected residents of all states equally. Some illustrative states are shown in the table.

Median Household Income, 1989, and Real Change, 1979 to 1989

State	Income (1989)	Income Rank	Change	Change Rank
Arkansas	$21,147	48	3.3%	20
California	35,798	8	17.1	9
Connecticut	41,721	1	24.0	3
Illinois	32,252	12	-0.4	28
Massachusetts	36,952	6	25.5	2
Michigan	31,020	15	-3.7	42
Mississippi	20,136	50	-0.7	33
New Hampshire	36,329	7	27.4	1
New York	32,965	11	18.2	8
Texas	27,016	32	-3.5	40
Wyoming	27,096	31	-19.1	50
United States	**30,056**	**n/a**	**6.5**	**n/a**

As the states shown illustrate, the 1979-1989 period picked up two major economic phenomena that are now completed: (1) the rapid growth experienced by states on the Atlantic and Pacific Coasts and (2) the impact of the sharp mid-1980s reduction in oil prices on Oil Patch states.

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Not every state faces average problems. Some states should escape 1993 without wrenching fiscal adjustments. Most will face unpleasant options, partly because their officials choose easy options this year and last year.

- Which States Have The Worst Problems? p. 5

State policy for health care seems to be falling into a pattern that few decisionmakers are stating explicitly but many are following. States will do what they can to provide health care and cover the uninsured, but only if other health care customers or federal government programs pay the extra costs.

- Health Care On Shoestring Budgets p. 11

While **Reports** sees little new in state health care financing besides making some health consumers and the federal government, not taxpayers, pay added health costs of the poor, many observers see state leadership, innovation, and even solutions to the national problems in health care finance. Why such a difference in views?

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Miscellany covers contrasting tax and spending priorities with performance, layoffs, pension funding, and Workers' Compensation. Technical notes detail sources and caveats.

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October 1992 (First Of Two October Issues)

ASSESSING STATE FINANCES

Look For Big Tax And Spending Changes In 1993

State finances are in poor shape, with little prospect for immediate improvement without decisive corrective actions by state officials.

Many states have run out of temporary palliatives. Hope for relief from federal action or sharp economic growth is fading. Most states will have legislators as far positioned from the next election as they can be. These circumstances suggest that 1993 will see much more serious debate over permanent fiscal adjustments than experienced this year. Such adjustments could be higher taxes, or reductions in spending patterns, or combinations of the two.

Why Fiscal Adjustments Seem Likely In 1993

Simply stated, most states have not fully adjusted to the factors adversely affecting their finances including: (1) economic stagnation, (2) sharply rising workloads as measured by prison populations, child abuse cases, and welfare and Medicaid participants, (3) a resumption of school enrollment growth after the stability of the 1980s, (4) few increases in federal aid outside of entitlements for welfare and Medicaid, (5) federal mandates increasing state and local costs. The most costly mandates aren't new ones but older ones with phased implementation. Their costs are now being felt in Medicaid eligibility, standards for health care providers, solid waste disposal, sewage treatment, services for the disabled, and other fields.

Slowness in adjusting to a changed fiscal environment has been exacerbated by special circumstances affecting state decisions in 1992 and, to a lesser degree, in 1991. Those circumstances will shift in 1993. They have included:

- **Fear Of Voter Reaction**: Legislators have always tried to avoid upsetting voters in election years by sharp spending cuts and tax increases. The normal fears were worse in 1992 because anti-incumbent sentiments have been at record levels and many legislators faced new constituents in reapportioned districts. Examples: legislators in **Maine** with a moratorium on partisan fighting over the budget, normally pro-tax legislators rejecting governor's tax proposals in **Illinois** and **Ohio**, and pro-tax legislators in **California** backing down when faced with a governor insistent on no tax increases.
- **Hope For Rescue**: Many state officials refused to believe that their state's economy would perform as poorly as it has, that welfare rolls would mushroom, that health care costs couldn't be controlled, and/or that the national economic stagnation would continue.

The optimism was particularly strong where problems appeared recently, as in **California**, and weak where the economic problems are long-standing, as in **Massachusetts**, **Mississippi**, and **West Virginia**.

- **Temporary Rescues**: Many states found fiscal salvation in health care finance: (1) retroactive Medicaid claims, (2) substituting cost-shared Medicaid for 100% state and local money in financing state institutions and public health services, and (3) the ease of enacting health care provider taxes without having them labeled tax increases. **New Hampshire** is the best example.

  Other states dealt with potential problems with reserves and rainy day funds husbanded for exactly the circumstances they faced. An example is **Indiana.**

- **Left-Over Good News**: Many states are still experiencing substantial, but not sustainable, budget relief from two favorable developments of the 1980s. The first was pension fund investment performance that outstripped actuarial assumptions. This permitted reductions in state employer contributions and improvements in local finances, making state aid freezes and cuts more palatable. **New York** was particularly benefited by this factor.

  The second was a continuing rise in taxable property values. This occurred even after market values ceased to increase because assessments lag market values in most states. Higher values make it easier for states to shift their problems to local governments as local officials can raise revenues without raising tax rates. In most school aid formulas, higher local values mean less state aid is required to meet state obligations. This factor helped in the Northeast, where the trend is now reversed, and in many Midwestern states.

- **"Bridge Financing"**: The concept of a bridge, spanning a low point between two higher points, is common in private financing, such as financing equity in a new house while an old one is being sold. The same concept rationalizes many state fiscal palliatives used in 1992 such as reducing balances and reserves below normal levels, borrowing from the marketplace or other state funds, asset sales, accelerating revenues, and retarding spending. Such bridges, used extensively in states like **California** and **Illinois**, only work if there is high ground on the other side.

These factors, with the exception of health care provider taxes, won't be significant in 1993 in most states. Elections will have been held. Optimism about state revenues and spending will be replaced with actual results, generally worse than forecasts. Optimism about 1993 will be tempered by a lower base from 1992 for revenue growth and a higher base for spending. Hopes for federal action can be tested against the budget proposals of a newly elected President. Good news about pension fund investments and assessed property values will be replaced with bad news. One-time palliatives will be replaced by the reality that last year's one-time financing is this year's addition to shortfalls.

Outside Help Probably Isn't On The Way

It is possible that state officials can escape the problems with help from two sources they can't control, the national economy and federal aid.

Most fiscal problems would be solved by a rapid economic recovery, such as real economic growth approximating the 6% annual increases experienced after some recessions. Few economists expect such growth. Reasons: (1) because the economy didn't fall as far in this recession as in some earlier ones, the recovery won't be as dramatic, (2) no major driving force, such as a war or pent-up demand for capital goods is on the horizon, (3) prosperity in other nations can't pull the U.S. economy upwards because those economies have problems of their own, and (4) the federal deficit makes massive federal pump-priming unlikely.

Federal action, such as a takeover of the state share of welfare programs or national health insurance, could provide a bailout for state finances. Nothing like this is in the cards. Even advocates of such actions minimize the immediate federal costs of their proposals by requiring the maintenance of state and local funding levels.

Early Signals of Problems

Don't look for many state officials to announce bad news before the November elections. It's not that the news isn't there, just that the timing for recognizing it is bad.

There are exceptions from state officials not seeking reelection, like the warnings from the governor of **Washington**. There are exceptions from states with strong traditions of recognizing and dealing with spending overruns quickly, such as Medicaid in **Arkansas** and **Nebraska** and school aid in **Texas**. There are also exceptions in states with problems too serious to deny or strong traditions quickly responding to potentially unbalanced budgets. Examples are the governor's administrative cutbacks in **Maryland** and **Ohio** and the actions of the Budget and Control Board in **South Carolina**.

Bond Ratings

Bond rating changes suggest the significant change in the fiscal position of the states. In 1991, Standard & Poor's issued more downgrades than in any other year in the past three decades.

Rating for states have been stable for decades. From 1962 to mid-1992, S&P upgraded 45 state ratings while downgrading 48 ratings. In the same period, Moody's raised 44 and lowered 46. In 1991, S&P dropped the ratings of eight states while Moody's dropped one. There has been more downgrading this year, including **California** and **Illinois**, but an upgrade for **Massachusetts**.

WHICH STATES HAVE THE WORST PROBLEMS?

Assessing 50 State Fiscal Situations

Many people could use an objective measure to determine which states will face fiscal problems in 1993. It would pinpoint states where taxpayers should grab their wallets, employees should worry about layoffs, universities and local officials should worry about cutbacks, and those who sell health and child care services to states should worry about reimbursement rate cuts and slow payments.

The number of states listed would depend on the outlook for the national economy and federal actions. Given assumptions about those factors, picking individual states objectively would depend on many factors, each state's (1) economic outlook relative to the nation's, (2) revenue system's ability to capture economic growth, (3) demographics, particularly enrollment growth and welfare participation, and (4) past fiscal decisions on subjects like reserves, rainy day funds, pension plan funding, and one-time financing measures. No one holds such data for all 50 states on a comparable basis.

While observers don't have data for precise measurement, they have enough knowledge of state fiscal conditions to make summary assessments. Based on the analyses in **Reports** and the state coverage in State Budget & Tax News, **Reports** can probably assess fiscal circumstances about as well as anyone who can discuss them publicly (experts paid by state dues cannot). While not a substitute for the detailed assessments many readers make of the states where they operate, the discussion in this article is probably a reasonably accurate assessment of how individual states relate to each other and national patterns.

Most States Face Serious Problems

The fiscal condition of the states can be divided into broad categories which aren't rigorously defined but are clear enough to represent meaningful distinctions.

About 17 states have decent, though tight, conditions. Eleven states are experiencing enough economic growth, despite national conditions, to be able to do their fiscal *business as usual*, that is, the way most states were able to operate in the late 1980s. Another six states are in situations that are *probably OK, but unpredictable*. These are small states with resource-oriented economies, most with large mineral trust funds that could be tapped as an alternative to tax increases or spending cuts.

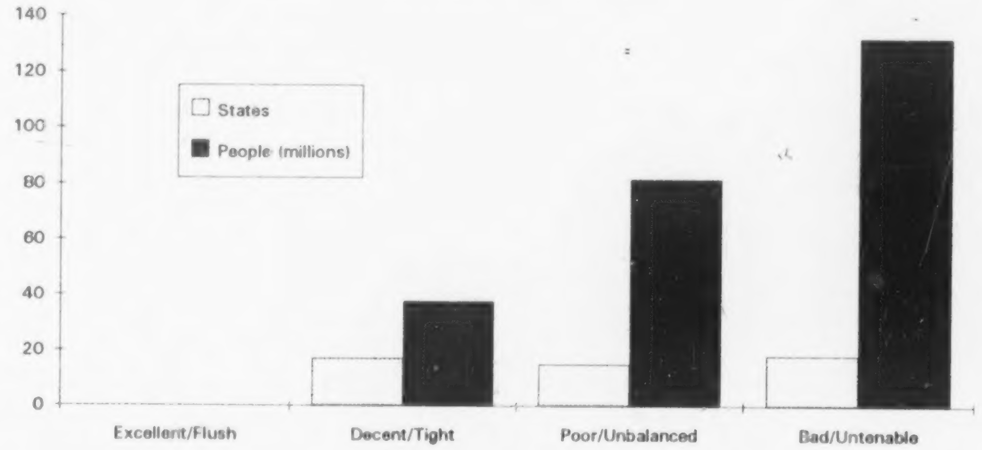
About 15 states are *close to the national average*. This isn't good as the national pattern suggests poor conditions with many FY 1993 budgets unbalanced and FY 1994 budgets aren't likely to be balanced with significant adjustments in spending and/or taxes.

About 18 states are in bad straits. Their fiscal policies appear untenable. That is, they won't be close to being able to continue current spending patterns with revenues from current taxes. Thirteen states have the *most serious fiscal issues* because of varying combinations of unusually poor economic conditions, demographic pressures such as unusual enrollment increases and welfare participation, and past failures to downsize government or increase revenues. Another five states aren't suffering as much from economic and demographic factors but have *self-imposed fiscal problems*.

Most People Live In States With Problems

Fiscal problems are disproportionately concentrated in the most heavily populated states. While about a third of the states have decent fiscal situations, only about 15% of the nation's population lives in those states. Over half the nation lives in the 18 states identified as having untenable fiscal circumstances. The contrasts are shown graphically below. The chart includes a new category, reflecting the fact that no states are classified as being in excellent condition. The category is for states that could comfortably consider costly initiatives without raising taxes or significant tax cuts without cutting current services.

Post-Election Fiscal Conditions



Business More Or Less As Usual (eleven states):

About a third of the states can probably handle their fiscal decisions in 1993 without wrenching adjustments in taxes or spending. Of course, they will all have problems because demands for spending will inevitably exceed revenues without new taxes.

Some may opt to raise taxes, but less out of necessity to continue current programs than because of decisions to lower other taxes, to spend more on schools, to provide earmarked funding for highways, to discourage cigarette consumption and fund special health programs, and/or to make health consumers pay for increasing costs of health care for the poor. Some may opt to cut current service spending levels in some programs to permit increases elsewhere and/or for policy reasons. Examples: cutting aid to cities and counties in the name of austerity and rationalizing responsibilities for delivering and financing services, cutting welfare in the name of welfare reform, and cutting higher education in the name of higher priorities elsewhere and more reliance on tuition.

Some of these states have made promises — explicitly in legislation or less explicitly by expectations and campaign promises — which they won't be able to keep without tax increases or sharp spending cuts. Examples are escalation in spending in multi-year school aid formulas and scheduled tax cuts.

Even among these more prosperous states, **there appears to be no state where significant state tax cuts will be adopted in 1993**, not counting cuts in one tax financed by increases in another.

The states likely to have the easiest time with their finances have three characteristics. First, their economy is outperforming the nation, generally showing employment growth of 1% or better in the last year. Second, they haven't dug an extraordinarily deep fiscal hole for themselves by borrowing, spending delays, large overestimates of revenue and underestimates of spending, and use of one-time budget balancing measures. Third, they haven't shot themselves in the fiscal foot by state court decisions or voter initiatives. These relatively fortunate states are:

Arkansas
Colorado
Idaho
Indiana
Kansas
Kentucky
Minnesota
New Mexico
Utah
West Virginia
Wisconsin

Probably OK, But Unpredictable (six states)

Some smaller Western states have unpredictable finances for several reasons. First, their economies and state revenues relay heavily on resources such as oil, gas, minerals, timber, and agriculture. As a result, their finances are highly subject to rapid fluctuations in world prices and prospects for these industries and to unpredictable national policy changes. Second, their tax systems are unbalanced, lacking taxes on personal income and/or on sales, making revenues more volatile than those of most states and creating constant pressures to adopt the missing taxes and reduce other tax burdens.

Third, their decisionmaking is less predictable. They often decide policy by initiative and referendum. They have unusual tendencies to intersperse periods of highly partisan stagnation with periods of consensus on rapid change. Fourth, most of these states have large mineral revenue trust funds with fiscal flexibility available should they decide to divert revenues to operations or raid principal. The economies of these states are in reasonable condition by national standards, though growth, particularly in Nevada, is below past levels. The states:

Alaska
Montana
Nevada
North Dakota
South Dakota
Wyoming

Close To The National Average (15 states)

These states are experiencing about the same sluggish economic performance as the nation as a whole. They share the kinds of problems described earlier in this article as leading to fiscal problems as early as now and as late as in their FY 1994 budgets to be considered next year. Most need large tax increases if they are to fund current service budgets as they define them locally — including legislated school aid increases, negotiated pay raises, scheduled tax cuts, and spending increases mandated by state courts or agreed to in federal court consent decrees. Put the other way, they need major cuts in spending patterns and to renege on some promises to avoid large tax increases. They are:

Arizona
Georgia
Hawaii
Illinois
Iowa
Michigan
Mississippi
Missouri
Nebraska
North Carolina
Ohio
Oklahoma
Tennessee
Virginia
Washington

States With Most Serious Fiscal Issues (13 states)

The states on this list are experiencing economic performance well below the national average. While some of them have already made significant adjustments in taxes and/or spending patterns, they probably will have to face another round. They are:

California
Connecticut
Delaware
Maine
Maryland
Massachusetts
New Hampshire
New Jersey
New York
Pennsylvania
Rhode Island
South Carolina
Vermont

Some of these states have done much better than others in making fiscal adjustments. All but perhaps **Maryland** have austere budgets.

Most have enacted large tax increases, most notably the new income tax in **Connecticut**. Previous large increases in **Massachusetts**, **New Jersey** and **Pennsylvania** were partly rolled back this year, leaving tight finances in all three. **Massachusetts** and **Rhode Island** have sharply cutback local aid as well as increasing taxes. **New York** has been adjusting to slow growth for years with mild tax increases, postponing scheduled tax reductions and spending increases, tuition increases, and austerity in spending for local and many state operations.

The adjustment process is least complete in **California** (where economic performance has been particularly poor and unexpected), **Maine**, **New Hampshire**, and **Vermont**. In the Granite State, which has survived only with unusual austerity and a windfall from Medicaid reimbursements, enacting a state income tax is a serious prospect.

States With Self-Imposed Fiscal Problems (five states)

Five states have special fiscal problems which developed out of state action and inaction with major fiscal impacts. From the perspective of outsiders, the conditions are self-inflicted because they were imposed by some form of state action. From the perspective of legislators and governors of these states, the conditions are uncontrollable because they are imposed by state constitutions, state voters, and state courts.

Alabama creates an automatic fiscal problem in its general fund by earmarking its best revenue sources for education. It pushed its legal risks to the limits last year by continuing two taxes (insurance premium and corporate franchise) that probably violate the U.S. Constitution's prohibition against state actions discriminating against interstate commerce. It pushed again by balancing last year's budget with differential fees for out-of-state and in-state hazardous waste disposal. They have already been adjudicated as unconstitutional. The state is also pushing the limits for creative financing of Medicaid. A major tax reform effort failed last year after passage by the House. A special session is being held this year to deal with fiscal problems, with reconsideration of tax reform (and increases) scheduled for early next year.

If the concept of budgets with *structural imbalance* were not already in use, someone would invent it to describe **Florida** finances. Demography has caught up with state spending, with rapidly rising school enrollments, increasing demands for university slots, and immense demand for infrastructure including roads, schools, and public buildings. A tax system designed to protect residents with a homestead exemption and a constitutional prohibition against taxing personal income won't accommodate the spending needs without less public service than Florida voters seem to want or further increases in taxes on the types of business the state seeks to encourage (e.g., manufacturing and tourism). This year, the governor sought $1.3 billion in new taxes and compromised on about $300 million. Next year, the same issues will be back.

After many tries at tax reform in the late 1980s, **Louisiana** settled into high reliance on business taxes, oil and gas revenues, and a highly regressive sales tax that is still considered "temporary." Major change was out in 1991, an election year. Tax changes weren't seriously considered in the legislative session this year because of a constitutional convention oriented to tax matters being held in the fall. With tax policy and levels undecided, legislators didn't cut back spending patterns, some of which (e.g., school aid) are enshrined in the state's constitution. The constitutional convention hasn't produced tax recommendations likely to solve the fiscal problem. Status quo financing in 1993 is out of the question without unanticipated increases in oil and gas prices.

Voters in **Oregon** have consistently complained about their high income and property taxes. But for decades they have rejected proposals to replace part of property tax revenues with a new sales tax. With enactment of Measure 5, they may have started a process that ends with a sales tax, but getting there won't be fun. The voter-initiated measure starts to bite heavily in the new biennium when rolled back property taxes are supposed to be replaced by large increments of state aid. Without tax increases or more economic growth than appears likely, the result would be one of the nation's most austere state budgets. But voters may not believe this until they see it. So they may see it. Or, legislators may decide to put a sales tax on the ballot. The governor suggested just that earlier this year, but the legislature rejected her proposal.

The **Texas** economy is doing fine by national standards. Texas finances suffer from high reliance on declining oil and gas production and sales taxes on goods. The state could probably slide by the new biennium by relaxing its Texas-size standards for universities (world-class), tuition (low), cash in trust funds (high), the percentage of population incarcerated (high), and selectively broadening its sales tax. It could create a fiscal crisis by moving to national averages in welfare payments (extremely low), welfare and Medicaid eligibility (low), and public sector salaries (relatively low). These issues are academic because the latest school finance arrangement has been held by state courts to be unconstitutional. It is based on property taxes that can't be collected after next summer.

Signs Of The Times?

The latest Department of Commerce estimates of state and local finances (second quarter of 1992 at seasonally adjusted annual rates) bring discouraging news about current fiscal conditions. The state and local deficit, excluding trust funds, is running at an annual total of about $40 billion. The deficit level is slightly below the revised estimate for the first quarter of 1992, but higher than in the fourth quarter of 1991. Pension funds, which should be adding assets rapidly to cover future retirement obligations, show a smaller surplus than any recent previous quarter. With lower interest rates, governments are earning less interest. With more debt, they are paying more interest.

HEALTH CARE ON SHOESTRING BUDGETS

Introduction, A Pattern Emerges

In late September, the Ohio legislature approved new taxes in a pre-election action that excited little controversy. By votes of 89-6 in the House and 37-1 in the Senate, the legislature revised its "care assurance" program. The legislation was sold on the basis of being necessary to comply with current federal Medicaid regulations and unavoidable for the state to continue current reimbursement levels for hospitals. It was a revision of Ohio's provider donation program adopted in 1988, but clearly takes the form of taxes that redistribute purchasing power. The lone dissenting vote in the Senate was from a Senator representing a Cleveland suburb which, for the first time, would find its major hospital (and thus its residents and their employers) contributing more in taxes than they received in Medicaid financing.

Ohio's action, and similar ones in other states, illustrate the increasing acceptability of provider taxes to legislators, governors, and health care providers. Officials of nearly every state are convincing providers, particularly hospital administrators, that neither additional state general fund money nor new taxes are likely to be available to finance escalating Medicaid costs and certainly not to raise reimbursement rates to levels the providers seek.

> *There's no way on God's green earth that the legislature will raise taxes again, so soon after 1990's tax hikes for school reform. And why should it? To further line the pockets of health-care providers? What fool of a politician would propose such a massive transfer of wealth, from all of us to some of the wealthiest among us?* — Columnist Robert Garrett, Louisville Courier-Journal (9/20).

Meanwhile, inaction is demonstrating that state officials are unwilling to make a deep plunge into financing programs for the uninsured outside of Medicaid. At least not using state money. Instead, they are looking for ways to convert costs of existing programs from financing by state and local taxes alone to federal-state cost sharing through Medicaid.

Easy Outs Are Out

If not state money for health care, then whose money? The two choices have always been the federal government and private employers. Neither choice is realistically available to state officials.

Making Employers Pay: Mandating employers to provide care, as many nation's do, isn't a tenable state policy if large employers can easily opt not to participate. They can, by shifting from buying insurance to self-insurance. Many are now making this shift just to avoid state mandates on what services must be covered and to avoid state insurance taxes. States cannot reach self-insurance by their powers over insurance because technically no insurance is purchased. States cannot reach self-insurance through their general legislative powers because such action is preempted by the federal Employee Retirement Income Security Act (ERISA). Efforts by the governors to get Congress to end the preemption, which are opposed by many groups, haven't been successful and have poor prospects.

It is conceivable that states could force employers to provide health plans for employees by use of the power to tax. This "play or pay" concept was the basis of the plan adopted by **Massachusetts**, but never implemented. The concept would, at a minimum, result in litigation with uncertain outcomes. More significant, state officials have been unwilling to subject their employers to required costs of 3-7% of payroll when employers in competing states aren't faced with such costs. The sole exception so far, **Hawaii**, enjoys a natural protection from interstate competition afforded by geography and protection from federal preemption because it has an exemption from the ERISA legislation.

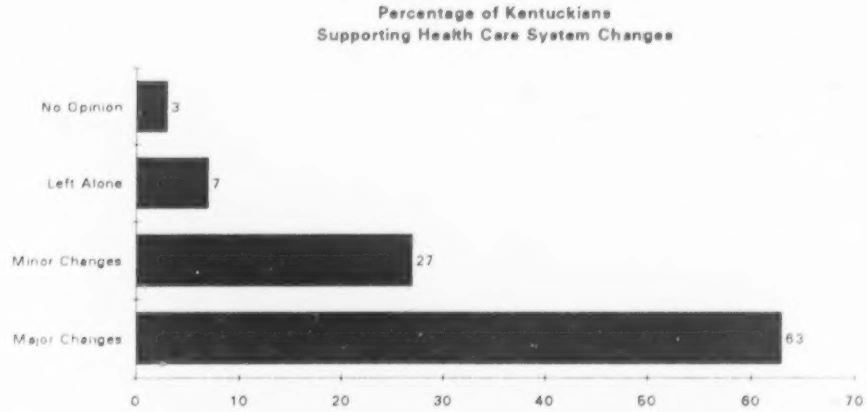
Making The Feds Pay: As readers are aware, health care financing is a major issue in the Presidential campaign and Congressional races. But, regardless of who is elected, state officials have little basis for predicting what the federal government will do. The range of possibilities is broad, from doing nothing to a full-scale national plan ending Medicaid and preempting all state health insurance mandates and indigent care programs. The possibility of federal action discourages decisive state action while the uncertainty about the form action will take discourages state action anticipating new federal action.

The Political Environment For State Action Is Poor

Public opinion presents major hazards for state initiatives to revise the health care system. A recent poll illustrates the ambivalence in public thinking on health care.

There is strong sentiment for change. A sample of Kentuckians was asked, "Do you think there need to be major changes in our health-care system, minor changes, or should the system be left pretty much the way it is?" The results (see chart, p. 13) show overwhelming support for change with little opposition and only 3% with no opinion.

The poll also indicates a high level of personal concern with ability to pay for care. About 20% of Kentucky adults said they were without health insurance at some time in the last year. About half of all Kentuckians with insurance say they worry "a great deal" about having to pay expensive bills not covered by their policies, 38% worry "a great deal" about having to pay larger premiums, and 37% worry "a great deal" about losing their coverage.



The problem for reformers is illustrated by the poll's question, "How do you feel about the health-care services that you and your family have used in the past few years?" About two-thirds of Kentuckians were satisfied with only a third dissatisfied. Having a large percentage of the population satisfied with their own personal arrangements while favoring changes in the broader system means that proposed reforms are vulnerable to attacks suggesting that the proposed reform would upset the existing arrangements. For example, a majority of Kentuckians would not enroll in a plan that would limit their choices of doctors and hospitals.

Satisfaction with existing personal arrangements and lack of consensus on possible reforms creates tremendous opportunities for any group dissatisfied with reform proposals to kindle opposition. Even simple measures like health care provider taxes are vulnerable. For example, Governor Wilder's early proposal was shelved after Virginia hospitals purchased advertising labeling it as a "sick tax." Without such opposition, the provider taxes have passed easily. State officials have dealt with the situation by making creditable threats that reimbursement rates would drop without provider taxes and promises they will rise with them. Easy passage of the proposals late in this year's legislative sessions in **Illinois** and **Rhode Island** are examples.

Consensus Is Hard To Forge

Because the politics of the situation seems to demand consensus involving major health care providers, state officials have opted for commissions and task forces designed to forge consensus. Some of these have failed. Others have found consensus only by agreeing on plans involving massive new resources from employer mandates, state general fund taxes, or both. The legislators being asked to vote the mandates and new taxes haven't been part of the consensus.

Many of the state commissions and task forces of the late 1980s have reported and been disbanded without noticeable impacts. Probably the best run at a commission-recommended plan was in **New Jersey**. The group's recommendations, presented in 1990, had strong support from key leaders of major firms, labor unions, and health care providers. Impetus for action was provided by the scheduled expiration of the unpopular and expensive surcharge on hospital bills to pay for uncompensated care. The plan fell to small business opposition to mandates and taxes and legislators' reluctance to impose new levies soon after raising sales and income taxes, which they correctly perceived would prove unpopular.

Currently active commissions are having difficulty forging consensus. The **Iowa** Leadership Consortium on Health Care has been meeting for two years under the leadership of a popular former governor. Disputes broke into the open in August, when the National Federation of Independent Business and major employers (e.g., Deere & Co. and Pioneer Hi-Bred) publicly objected to the group's central thrust. The **Texas** Health Policy Task Force recently backed off strong support of a single payer plan because of insurance company opposition. The **Washington** Health Care Commission has been working for two years against a deadline of this November. Agreement is unlikely. A key legislator is pushing a ballot proposal with one plan, physicians have another, insurers have another, and yet others are being discussed.

This year's **Florida** plan is actually just a plan to make a plan. The new Agency for Health Care Administration is supposed to recommend a plan by the end of this year. But the governor and others see federal legislation (ERISA exemption and Medicaid flexibility) as critical to achieving the goal. Advised that Congressional action this year was unlikely, the agency head commented, "We said from the beginning we couldn't get there {affordable health care for all} by ourselves." He plans to submit two proposals, one assuming federal action and one assuming federal inaction.

State commissions continue to be appointed. **South Dakota**'s governor recently appointed members of the commission established by legislation this year. The group is expected to be making recommendations through 1995, with some hope it will have reform proposals for the 1993 session.

Little Funding For Prevention Programs

> *Why not increase preventive care to reduce costs? Because, as there are never enough funds to satisfy current needs, then there are certainly too few dollars to embark on meaningful prevention programs. Ideally the states should be spending for prevention. Realistically they will not be.* — Robert Mandeville, former Illinois Budget Director, OpEd Chicago Tribune (9/28).

State elected officials have long stressed the concept that prevention is a cheaper, more humane, more cost-effective, and generally superior approach to health than spending on health care after health problems have developed. Public health experts, in and out of state government, and citizen groups have a long list of areas where prevention spending should be increased. With the federal government showing little sign of expanding its spending, these groups are looking to the states. Out of the list of proposals, there are many that have appealed to state officials:

- **Public health education** on such subjects as nutrition, smoking, alcohol consumption, prenatal care, and periodic examinations.
- **Traditional public health measures** such as inoculation of children against diphtheria and care of patients with highly contagious diseases such as AIDS and tuberculosis.
- **Subsidy** of costs of diagnostic procedures used for prevention, such as mammography, by use of mandates in private health plans and other forms of public support for persons not on Medicaid.
- **Increased** efforts to deal with environmental health risks such as radon, pure drinking water, and workplace environmental standards.
- **Improved prenatal care**, particularly for low-income families.

These programs have not fared nearly as well in budget allocations as in rhetoric allocations. Traditional public health activities are one of the "other" programs that tend to be squeezed by across-the-board cuts and hiring freezes as state officials attempt to accommodate escalating Medicaid and corrections costs, provide increases for public schools, and avoid tax increases.

One reason for the difference between health-oriented rhetoric and reality-oriented budgeting is that prevention programs do not save money, in the sense of relieving costs in present or future budgets. Costs of care in Medicaid and charity hospitals cannot be reduced in a particular year's budget just because spending on prevention is increased.

It is doubtful that prevention saves state funds in the long run. Prolonging life is a valued objective, but not as a money-saving measure. Success in prolonging life puts more people into the higher age brackets where Medicaid pays for about half of all nursing home costs and for expensive procedures (e.g., prostrate surgery) used primarily by older persons.

Medicaid Costs Rising

If people want the kind of Medicaid program they say they do, then the only solution is for the legislature to come up with the money. — Arkansas' Medicaid Director on the FY 1993 shortfall.

Measuring Spending Increases: State general fund budgets have become poor measures of Medicaid cost escalation. Many states are treating provider tax revenues and the state and federal spending they finance as off-budget. Shifting costs, such as those of state institutions, from state to Medicaid funding often increases total costs, but reduces state general fund outlays. As a result, some states are incurring 10-30% increases in Medicaid costs while reporting that state spending for health care and/or Medicaid isn't rising much. Some states, notably **Illinois**, are borrowing money to pay Medicaid bills.

The best current measure of Medicaid's rapid growth is the 20-30% annual rate of increase in federal Medicaid spending. Because the federal matching ratio is unchanged, these outlays mean the states are convincing federal reviewers that state outlays are increasing at the same rate.

Outlays Could Exceed Appropriations This Year: All the election-year incentives argued for underestimating Medicaid costs in this year's enactment of FY 1993 budgets. Underestimating helps avoid the apparent necessity for pre-election tax increases or sharp spending cutbacks. It also avoids the perceived unpopular move of providing greater percentage increases for Medicaid than for public schools.

In the spirit of such underestimates, announcements of projected shortfalls should be rare before November. But they would be common when supplemental appropriation requests accompanying proposed FY 1994 budgets are released in December and January. In this context, two states publicly dealing with Medicaid deficits may be signs of what will come in other states.

Overruns In Arkansas: Allowing any program to spend at a rate that is not sustainable for a full fiscal year is more contrary to the budget culture of **Arkansas** than of most states. The state also has more serious enrollment escalation, with Medicaid rolls up 11% from a year ago.

Acting administratively, Arkansas has rolled back many of its discretionary expansions of eligibility and services including most optional services and eligibility for pregnant women and infants between 185% and 133% of the federal poverty level. A cut in physician reimbursement rates was announced, but quickly embroiled in litigation.

Overruns In Nebraska: Medicaid enrollment, which increased from under 100,000 in 1990 to over 120,000 this year, is also part of the problem in **Nebraska**. Another part is reimbursement rates. They have increased for nursing homes, reflecting new federal quality standards. They may increase for hospitals if the state settles litigation brought under the federal Boren Amendment (on reasonable cost reimbursement). Medicaid ran over its budget in FY 1992 by $7 million and was expected to overrun by $10 million this year, until a September announcement by the social services director suggested $20 million would be a better number. A special legislative session is expected to deal with the problem this fall.

Controlling Treatment Costs

> *Illinois Medicaid coverage is better than the insurance plans for both its own state workers and for employees in a typical private sector health-care program. There are no deductibles, no out-of-pocket expenses, and no limits on coverage. As an economist might say, Medicaid is a free good for enrollees.* —Mandeville (9/28).
>
> *Although this was an isolated incident, Chip Rowan of the AIDS Legal Project sees it as "a viable prospect for the future."* — Atlanta Constitution *(8/29)* describing an Alabama man with AIDS who said he stole a VCR to get back in jail so he could get the expensive drug AZT. The Constitution discusses potential prisoners in Georgia trying to get jailed to get medical care and countermeasures by law enforcement agencies to send them home.

While states have experienced considerable success in getting health consumers to pay Medicaid costs by provider taxes, there is little success in controlling costs. Everything looks uncontrollable to Medicaid administrators. Most enrollment (participation) is controlled by federal mandates and participation in cash assistance programs. How much service is consumed is largely set by recipients and their health care providers. The reimbursement rates are hard to control in any case and harder with litigation under the Boren Amendment and the need to enlist provider support for provider taxes. Claims of potential savings associated with using managed care and health maintenance organizations have become more modest as experience has increased.

Employers And The Federal Government Aren't Helping

While private employer health coverage and federal action may be the long-term salvation for states struggling to deal with health costs, the actions of the federal government and employers are aggravating current problems with no relief in sight.

Employers: Employers are trying to control their own costs. One way to do this is to avoid state mandates of coverage by use of self-insurance and simply by not providing coverage. Another is to litigate against the state plans that seek to cover hospital care for uninsured residents by large surcharges on paying customers. Litigation, contending the ERISA legislation prevents this, has put plans in **Massachusetts**, **New Jersey**, and other states in jeopardy. Yet another is for employers to force employees to pay a greater share of their costs by: co-payments, deductibles, exclusions of coverage. and ceilings on large payments. Each mechanism has the potential to force employees into Medicaid for expensive treatments, such as those associated with AIDS. These actions, which are common: (1) tend to increase costs left for Medicaid, (2) increase the pool of uninsured persons not eligible for Medicaid who would have to be covered by state universal health plans, and (3) increase the amounts of unreimbursed hospital costs.

Federal Government: Ross Perot's book, United We Stand, may or may not help achieve the author's political ambitions but suggests what could happen in federal policymaking. When Perot addresses health care, he does the same things as other candidates and state officials: (1) criticizes the cost of the current system, (2) endorses prevention and cost-containment, and (3) supports a national health policy (with unspecified basic benefits) achieved through "reaching a consensus," "encouraging problem solving by everyone involved," and "appropriate tax treatment."

Another portion of Perot's book combines many oft-considered mechanisms for balancing the federal budget. The suggestions are selections from budget option lists of the Congressional Budget Office and various expert recommendations, some of which could be taken seriously as early as 1993 regardless of who is elected to federal office. The key ones affecting state health care policy:

- Requiring Medicare recipients to fund 35% of their costs, up from 25% currently. States are mandated to "buy into" this coverage on behalf of cash assistance recipients, so states would pay part of the increase.
- End the tax exemption for employer-paid health insurance exceeding $335 a month for family coverage and $135 for individuals. Comprehensive plans already cost more than this, so employees (including state and local employees) would pay income tax on the excess. Private employers, and to some extent state and local governments, would find if both were taxed equally, many employee organizations would be more interested in employer payment of the excess as wages and salaries than as health insurance. Given the money, some individual employees would buy added employer coverage, but some wouldn't, further increasing health services left uncovered by insurance because of limits on health plan benefits.

The offsetting gain for states with income taxes that conformed to the federal policy would be the added income tax revenue.

- ♣ Raise the federal tax on tobacco. Higher resulting prices would discourage consumption, as advocates desire. But the declining consumption would cut revenues from existing state tobacco taxes, some of which have revenues earmarked for health programs, and discourage enactment of the many proposals for higher state taxes with earmarked revenues.
- ♣ Cap Medicaid spending growth. No Presidential candidate is advocating this precisely, but the numbers for it find their way into savings estimates. Perot counts $141 billion over five years from health care reform "to improve the quality and delivery of medical services through Medicare and Medicaid."
- ♣ Cut other federal health outlays. The Perot prescription is a 10% cut for what is called federal discretionary spending. Because hard-to-cut programs like IRS tax collection and federal law enforcement are in the 10% and easier-to-cut programs like space and rural electrification are separately counted upon for extra savings, an across-the-board cut might fall disproportionately on health activities. The health programs at risk include a variety of federal grants for state-administered programs and direct federal activities (e.g., with Indian tribes and migrant workers) where states would have heavy responsibilities for dealing with any resulting unmet health care needs.

The Outlook

New taxes on health care providers helped many states weather fiscal problems in 1991 and 1992 and appear to have additional potentials for nearly all states for dealing with rising health care costs in 1993. Given choices of raising general taxes and holding education increases to below-inflation levels, provider taxes are likely to be where much of the action in state money-raising occurs in 1993. With broader choices, state officials might not opt to raise health care prices by taxing health services, but are likely to work pragmatically with the choices they have. They don't have to feel good about the resulting health care, state, or federal policies. Many would probably agree with the concluding paragraph of "**Hemorrhage**" a Forbes (9/28) discussion of Medicaid:

> *The states cannot afford to sustain the Medicaid largesse on their own. For example, this year, even after using some tricks to pass costs back to the feds, Florida had to funnel two-thirds of all new state general revenues to Medicaid, crowding out spending for other needs. Faced with the same crowding out, Colorado's legislature voted this year to drop out of Medicaid. The governor vetoed the bill, but the message was clear. There has to be a better way to provide health care to the poor.*

PERSPECTIVES ON STATE HEALTH FINANCING

Differing Assessments Of State Action

The **Reports** assessment of prospects for state financing of health care for the poor and uninsured boils down to an unappealing bottom line. While states may cover some escalating costs of current coverage with general funds, they are unlikely to finance expansions of coverage under Medicaid or other programs unless that expansion is paid for by the federal government or levies on other consumers of health care.

Many state officials are presenting initiatives in more appealing terms than these. Associations of state officials, particular the National Governors' Association, have published many materials making the case that states are implementing major innovations in health care finance. State officials seeking reelection are touting what they have done. Candidates for state office are talking enthusiastically about what they will do. Some journalists have written favorably and optimistically about the significance of state action.

Differing Assessments Of What Has Been Done

One cause of the differing assessments just reflects a tendency of incumbents' public statements and their associations' publications to take a more sanguine view of incumbents' accomplishments than the view taken by an independent publication. Other causes are more substantive. The differing views appear in the areas summarized below.

Demonstration And Pilot Programs: Many states are undertaking health care delivery and financing projects for selected populations representing a fraction of the clients and cost of applying the same policies statewide. "Seed money" for these programs has come from private funds, the federal government, and state general funds. One view is that these are the early steps on the road to more universal programs. Another is that they are the response to strong pressures for action conflicting with compelling reasons, mostly fiscal but also programmatic, for not taking it.

Time will tell. It has told in the case of welfare reform demonstration programs involving job training, where demonstrations have become a federal program for which many states are not willing to provide matching funds. The outcome is uncertain for education reform demonstrations and pilot programs. Some have been dropped in competition for funds with unrestricted school aid but some have shifted to statewide funding and/or mandates. In the case of demonstrations which deliver improved care, but appear to raise Medicaid costs, the federal attitude toward waivers will also be significant.

Plans To Make Plans: Another source of differing perspectives involves what significance to attach to legislation of the type passed in **Florida**, **Minnesota**, and **Vermont**. To differing degrees, these laws *enact a plan*, designate an agency to study and report the specifics of the plan, and require further legislative action before something major (like a new tax on employers who don't comply with mandated coverage for employees) happens. One view is that such laws differ little from oft-tried laws that *enact a policy statement*, designate an agency or commission to study and report how to achieve the policy, and require further legislative action before something major happens. Another view is that the enacted plans should be treated as tantamount to final legislation, or at least more significant than mere studies, Blue Ribbon commissions, and task forces.

Many observers treat federal rejection of the **Oregon** plan as a temporary setback soon to be remedied. Others have doubts over federal approval of a revised plan and whether Oregon legislators, now preoccupied with an untenable fiscal situation, will implement the plan even if it is approved in Washington.

Affordable Coverage: Many states have adopted plans to encourage more employers, particularly small employers, to provide employee health coverage and to enhance individual coverage for those with special health problems by reducing prices and discouraging denials of coverage. No one doubts that these work to the extent funded by general taxpayers through appropriations and tax credits. The questions are over how much money is needed and whether state officials will provide it.

The other elements of the plans are simple ideas: (1) making plans cheaper by exempting them from past state mandates of coverage and (2) making coverage cheaper for some customers by making it more expensive for others, as is now done in assigned risk plans in auto insurance and Workers' Compensation. These actions should achieve the objective of lower costs, but at a price. The results may be good or bad, but won't be dramatic.

Federal Action: Optimists about state actions that improve health care financing hope for federal approval of ERISA exemptions and considerable new flexibility in Medicaid. Some Medicaid plans assume federal consent to eliminating "freedom of choice" among providers, to denying some services now covered, and to covering costs not now covered. Pessimists fear federal inaction on the ERISA exemptions (opposed by business and much of organized labor). They also fear that federal policy will either reject all waivers that might increase federal cost or allow states flexibility only in return for Medicaid spending caps.

Pessimists also worry that it will not take federal budget cutters long to argue that federally paid costs (e.g., purchased care for military personnel and dependents, Medicare, Medicaid, and other programs) should be exempt from provider taxes.

MISCELLANY

Fiscal Priorities And Performance

The latest Department of Commerce estimates of state and local finances (Survey Of Current Business, August) suggest that priorities reflected in performance are the opposite of public preferences as reflected in most polls. In taxes, practice has preferred property taxes. The biggest spending gain is in transfer payments, such as welfare and Medicaid.

Percentage Increases In State and Local Spending And Revenues
Periods Ending In The Second Quarter Of 1992 (National Income Accounts Basis)

Category	Last Year	Last Quarter
Property Taxes	7.6%	1.9%
Sales Taxes	6.5	.5
Income Taxes	5.8	1.0
Transfer Payment (welfare) Spending	18.7	3.9
Employee Compensation	4.4	1.6
Purchases (e.g., supplies, infrastructure)	1.2	-0.6

Layoffs Of State Employees

While major layoffs have been threatened in many states over the past two years, few have occurred. The major exception is **New Jersey** where some 2,000 workers were slated to be axed in October as a result of tight fiscal circumstances and the legislature's decision (overriding a veto) to roll back the 1990 sales tax increase.

The legislature directed that layoffs be confined to jobs paying more than $50,000, but the Florio Administration claims this is impossible. Employee organizations have fought the layoffs in court, in part on the grounds that the legislative language in appropriations bills usurps executive powers. Whether appropriations alone restrain employment or layoffs are concentrated on high-wage workers, much of the impact will ultimately fall on low-wage workers. New Jersey has extensive "bumping" rights, so the personnel director estimates each layoff will affect as many as four or five workers as laid off workers bump lesser paid workers out of their jobs and the bumped workers exercise their bumping rights. Because no one knows how many displaced workers will opt for retirement or seek other jobs, no one knows how many workers will finally be laid off.

There are also significant layoffs associated with FY 1993 budgets in **California** and **Illinois**, with cutbacks of enacted appropriations in **Alabama**, and probably with both in some other states. Because of bumping and lags in decisionmaking as administrators consider how to take cuts, exactly what will happen in these states isn't yet known.

Pension Funding

Revisions in actuarial assumptions and funding schedules for state-administered pension plans for state and local employees played a major role in FY 1993 budget-balancing. For example, **New Jersey** produced $700 million of state fiscal relief and reduced financial pressures on school districts making smaller state aid increases more tenable.

Two common changes are revaluing security holdings from book to market value and altering the assumed rate of return on investment. *These assumptions are interactive.* It may be appropriate to assume a return of 8.5% and may be appropriate to use book values that are, say, 80% of market value. The net effect is the same as assuming 6.8% and using market value. More risk of inaccuracy occurs when state and local contribution requirements are lowered by switching to market values *and* increasing rate of return assumptions.

Revisions in actuarial assumptions have put some states at substantial risk of not meeting their funding targets. Particularly in the plans heavily invested in short term obligations, the lower interest rates being experienced by individual investors in certificates of deposit and U.S. Treasury bills and notes have already reduced investment earnings. For systems that value assets at market prices, stable stock prices have meant reporting little or no return from appreciation. Private pension managers face the same problem as public plan managers. As the Wall Street Journal recently (10/5) headlined, "Pension Fund Managers Face Moment Of Truth As Interest Rates Plunge And Equities Stagnate." If long term interest rates rise, as sooner or later they could be expected to do, the market values of long-term bonds (and perhaps stocks) held by pension funds would be expected to drop.

Workers' Compensation On Front Burners

Workers' Compensation issues are drawing attention in many states. In **Pennsylvania**, the governor called the legislature into an October special session to attempt to agree on a workers' compensation reform package. Without action, one forecast is that rates would rise by 40-55%. In **California**, Governor Wilson is saying the state is short 1,250,000 jobs (750,000 actually lost, the rest from growth that should have occurred but didn't). Blaming recession for about half the loss and state policy for the rest, he also called an October special session to deal with WC reform.

The issues are highly partisan in both states. For example, Governor Wilson (R) told a business audience that if lawmakers won't change the WC law in October, "we must change the lawmakers." A leading House Democrat on WC issues called the governor's call for the special session "full of shrill, Democrat-bashing, language." and "hysterical, overblown, deceptive rhetoric."

In **Maine,** WC, not fiscal issues, delayed the budget last year. Now, legislators are considering reforms suggested by the Blue Ribbon Commission whose appointment resolved last year's problem. In **Missouri**, the gubernatorial candidates are running ads saying their opponents have improperly benefited from WC — one for large campaign contributions from lawyers that he hired as attorney general to defend the state's second injury fund against claims and the other for large fees for representing WC claimants.

TECHNICAL NOTES

State Finances: Classifying states' fiscal positions obviously required educated guesswork, but the framework for it was rigorous. *Current service spending* was defined as continuing current policies with adjustments for inflation and workload changes (e.g., enrollment, prison populations). The definition excludes self-imposed spending increases, such as scheduled escalation in school aid spending beyond inflation and enrollment-driven changes and spending to comply with consent decrees. The definition includes pay changes matching inflation, which many states don't include. For *revenues from current taxes*, scheduled expirations of temporary taxes and scheduled tax reductions were ignored.

The bond rating changes come from Sarah Ritchie's Credit Rating Changes: An Indicator of State Fiscal Stress (Center for the Study of the States, Rockefeller Institute of Government, 411 State St., Albany, NY 12203). Ritchie finds a close correlation between ratings and **Reports**' Index of State Economic Momentum. As of late July, both Moody's top rating (Aaa) and S&P's (AAA) were held by only six states: Maryland, Missouri, the Carolinas, Utah, and Virginia. Both agencies agree that the bottom ranked states are Louisiana, Massachusetts, and New York, but disagree on the order and the letter rankings.

For more pessimism on the states' fiscal outlook ("fundamental budget problems remain"), see Ronald Snell (NCSL), "The Malaise Lingers," State Legislatures (October).

Health Finance: The Kentucky poll was reported in the Louisville Courier-Journal (9/27). For a readable presentation of the view that impressive progress is occurring see Penelope Lemov's "Health Care Reform: The States Get Serious," Governing (Oct.).

Workers' Compensation: For a national summary of the issues, see "The Agony Of Workers' Comp.," State Government News (Oct.). The Ford Foundation's recent awards for innovation (Governing, Oct.) include one to Oregon for managing WC, though not everyone would agree with some of the policies (e.g., benefit cuts, using a government-run fund rather than competing private insurance companies).

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STATE POLICY REPORTS

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Many state officials are finding that nearly all of their spending is "uncontrollable." Proponents of the remaining "controllable" and thus vulnerable programs are wondering how to become uncontrollable.

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New statistics show the poverty rate ranging from under 6% in Connecticut to nearly 24% in Mississippi.

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Candidates are counting opponents' tax increases, but most of the growth in tax revenues comes automatically. New economic forecasts and recent tax collections suggest automatic growth may not be enough.

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October 1992 (Second Of Two October Issues)

COMPETING FOR JOBS

The competition for economic development remains intense even though states don't have much money to spend to seek new jobs and the private sector isn't creating many jobs for states to chase.

New Development Incentives In Massachusetts?

This fall Governor Weld is actively campaigning for his development strategy. The effort isn't noteworthy for the proposals, which reflect policies under consideration in some states and in effect in others. More noteworthy is who is proposing them, at what cost, and with what rationale. Weld gets considerable national attention as a dynamic, personable Republican governor who has shown electability in one of the nation's most Democratically inclined states and who takes credit for turning around the finances of a deficit-ridden government. These characteristics make him a national figure and his view on state economic strategies more significant than the average governor's.

Part of the program is pure tax policy. The proposals, lowering taxes on capital gains and increasing business tax credits, would be evenhandedly applied in the name of improving the state's economic climate. The current program reflects a partial shift because his earlier proposal to reduce the personal income tax rate has been dropped in favor of incentives more targeted to investors and business. The proposals are drawing opposition from those who don't believe that the state's budget is in good enough shape to afford the revenue loss and those who believe that if money is available, it should be used for spending rather than tax cuts. The governor's plan also includes acceleration of infrastructure investment and a version of enterprise zones, with additional tax benefits to companies expanding jobs in the zones.

The program involves a state "industrial policy," providing assistance to specific firms. The amounts involved are relatively small. The proposals are for the state to begin:

- An **Emergency Technology Fund** that would use $30 million for corporate manufacturing and R&D facilities by partial loan guarantees, subordinated debt financing, and other techniques putting state money at risk.
- A **Small Business Capital Access Program** (modeled on an existing program in Michigan) that would provide $10 million to banks to encourage them to make loans for small business that they wouldn't otherwise make.
- An **Export Finance Program** using $10 million to provide loan guarantees to Massachusetts companies, particularly smaller ones.

The Senate President (D) argues that these programs are a "crystal clear" violation of a state constitutional provision which prohibits using state money to assist privately owned companies. Similar programs have encountered similar obstacles in other states, with some state constitutions modified to make the programs possible. The governor acknowledges that his plan "does make some conservatives nervous," His rationale depends upon the concept of market failure. That is, that the free market should generally be relied upon for capital financing of specific firms with governments not picking particular firms, but government intervention may be appropriate if the market is failing for some reason. Many state officials, particularly in New England, believe that the markets overlook profitable opportunities for certain forms of business investment, such as long-term capital investments in small and medium-sized firms.

While some business leaders and state officials have reservations about what they call "picking winners," the concept seems likely to be accepted in Massachusetts. Some leading Democrats, including the speaker, have proposals of their own. A key business group, Associated Industries of Massachusetts, has endorsed the philosophy of these bills and the governor's. The group's newsletter (9/25) comments:

> *Although our recovery depends in large measure upon national economic trends, state government action can be an important catalyst for revitalization. Competing states know this. In the Northeast, New York provided $46 million in loan and loan guarantees between April and July; New Jersey has just announced a $25 million venture capital fund to supplement its existing guarantee program; and the massive $1 billion "Connecticut Works" effort has already saved or created many jobs in our hard-pressed neighboring state.*

The governor is also proposing to merge ten development-oriented agencies, many quasi-public bond issuing agencies. Reflecting many of the development ideas of the 1980s, the Massachusetts list is longer than most:

Bay State Skills Corporation
Industrial Services Program
Massachusetts Community Development Finance Corporation
Massachusetts Community Economic Development Assistance Corporation
Massachusetts Education Financing Authority
Massachusetts Government Land Bank
Massachusetts Health and Educational Facilities Authority
Massachusetts Industrial Finance Agency
Massachusetts Microelectronics Center
Massachusetts Technology Development Corporation

Fastest Growing Private Companies

For the past 11 years, Inc. magazine has prepared a list of 500 American companies that are both relatively small and exhibiting rapid growth. To provide comparability among states, **Reports** counted the winning companies in relation to population. The results are shown on the table.

Number Of Inc. Fast-Growing Companies Per Million Residents, 1992

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Idaho	4.81	18	Wisconsin	2.22	34	Illinois	1.13
2	Virginia	4.77	19	Oklahoma	2.20	35	West Virginia	1.11
3	Colorado	4.74	20	Washington	2.19	36	Kentucky	1.08
4	Utah	4.52	21	Wyoming	2.17	37	North Carolina	1.04
5	Arizona	4.00	22	Indiana	2.14	38	Rhode Island	1.00
6	Vermont	3.53	23	Oregon	2.05	39	Alabama	0.98
7	Massachusetts	3.50	24	Minnesota	2.03	40	Maine	0.81
8	New Mexico	3.23		**United States**	**1.98**	41	Nevada	0.78
9	Delaware	2.94	25	New Jersey	1.80	42	Mississippi	0.77
10	Georgia	2.87	26	Tennessee	1.62	43	Iowa	0.72
11	New Hampshire	2.71	27	Kansas	1.60	44	Louisiana	0.71
12	California	2.57	28	Missouri	1.55	45	South Carolina	0.56
13	Nebraska	2.51	29	New York	1.44	46	Alaska	0
14	Maryland	2.47	30	South Dakota	1.42	47	Arkansas	0
15	Connecticut	2.43	31	Ohio	1.19	48	Hawaii	0
16	Texas	2.36	32	Michigan	1.17	49	Montana	0
17	Florida	2.26	33	Pennsylvania	1.17	50	North Dakota	0

As might be expected, there is a reasonably close relationship between successful companies and a state's Index of State Economic Momentum (Issue 18). This reflects both the tendency of fast-growing companies selling in international markets to contribute to a state's growth and the contribution a fast-growing environment makes to a company's growth. In this context, it is noteworthy that some states now with stagnant economies (e.g., **California**, **Connecticut**, and **Massachusetts**) placed in the top third.

States And The International Economy

Speakers on economic topics are fond of reminding their audiences that the economy is constantly becoming more globalized. This assessment, if measured by the percentage of domestic demand satisfied by imports or the percentage of domestic jobs associated with exports and international tourism, is clearly true. The question is how states should react

The general reaction in state policy has been to adjust current programs to recognize the importance of international markets. In this spirit, industrial development programs, in some states more than others, consider foreign as well as domestic firms as their targets. Some have impressive results, such as the BMW plant being built in **South Carolina**, to show for their efforts. Programs to encourage growth of in-state businesses now have export promotion components. Tourism programs of many states seek to reach international as well as domestic travelers.

Beyond these, state actions show a mixed pattern. States are still establishing offices abroad to promote trade and investment, but many offices established in the past are being shut down. By one count, about a dozen states have closed or reduced their offices in Japan, including closures of Tokyo offices by **Pennsylvania**, **Texas**, and five smaller states. States are developing varied mechanisms to consider international developments in a state policy context, such as the establishment of a special position of assistant director for international relations in the **Kentucky** Legislative Research Commission staff. There are several new publications designed to help state officials decide how to respond to globalization (see Technical Notes).

Connecticut Bets On Sports

Connecticut is seeking to deal with its continuing economic woes with the massive "Connecticut Works" effort for business assistance. The state has made $150 million worth of loans and loan guarantees in the last 18 months, including going further in involvement with sports teams (as distinct from stadiums) than other states. The state is making what would have to be called a high risk loan to the Hartford-based Whalers, the hockey team that is the only major professional team based in the state. A Connecticut agency is also guaranteeing $10 million of loans to the team. It has been losing money due to some combination of hard times in its attendance area and poor performance on the ice. The Hartford Civic Center, where the team plays home games, is increasingly becoming the commercial anchor of downtown Hartford, which recently lost its last major department store.

State Development Wars

Kentucky v. Ohio: In January, Ohio firms will start receiving an estimated $30 million in tax reductions from a special industrial development package passed with few dissenting votes at a recent special session of the legislature. The legislation exempts purchase of equipment for research and development from the sales tax and provides tax credits for expanded employment associated with job expansion. Citing competition with other states, Ohio's governor is encouraging the legislature to pass a Workers' Compensation reform bill by the end of the year.

In support of his proposals, Governor Voinovich told legislators that over the past ten years Kentucky manufacturing employment has grown 15% while Ohio's declined by 4%. He cited lower taxes and Workers' Compensation rates as two Kentucky advantages. The incentive bill's sponsor said that three firms had recently moved across the river from the Cincinnati area to take advantage of the Kentucky Job Development Act. It offers a ten-year reprieve from state income taxes for companies that: (1) have three-fourths of their sales outside of Kentucky, (2) add 25 or more jobs, and (3) relocate to Kentucky.

Ohio v. Illinois: While much of the impetus for Ohio's action came from competition with Kentucky, the legislation got a strong boost from success in competing with Illinois. Ohio won the competition for a Spiegel Inc. distribution center with 1,500 jobs over several states, including Illinois where the firm's distribution activity is now located. Ohio officials told Spiegel executives about the pending legislation and the likelihood that it would pass. In supporting the bill in late September, the Ohio House speaker told members that Spiegel wanted passage by early October.

North Carolina v. East Coast Port States: North Carolina has new legislation to encourage use of the ocean ports at Wilmington and Morehead City. A tax credit is based on current use of the ports compared with use during a three year base period.

New Jersey v. New York For Office Locations: First Chicago Trust Company recently signed a lease to occupy Jersey City office space, moving about 1,000 employees from Manhattan. The decision was encouraged by a New Jersey decision to pay about $6 million ($6,000 per employee) to complete the office space to the firm's specifications and to furnish and equip it. The money to pay these costs comes from the state's new $200+ million war chest called the Economic Recovery Fund. The New York Times (10/7) called the action "an escalation in the office war it {New Jersey} has waged with New York City."

Besides the special concession on furnishing, First Chicago will get the substantial state concessions offered to firms operating in Urban Enterprise Zones. They include:

- A break of about 50% on real estate taxes,
- A discount on electric rates of 7-10% for seven years, augmented by a reduction of 25% in the first year, and
- A 15-year exemption from sales taxes on essentially all the company's purchases.

Besides special concessions, the New Jersey location had other advantages. While New Jersey and New York both have state personal income taxes, New York City has a graduated local tax which has no counterpart in New Jersey. Also, the building owners in New Jersey clearly made price concessions to find a major tenant for their unoccupied space.

The tax angle was blamed for New York City's economic woes by a city council staff member in an OpEd in the Wall Street Journal (10/6). Stephen Kagann calculates that since April 1989 the city has lost 360,000 jobs, a fifth of the national total. The city's private sector job loss is 15%, if private jobs supported by public health care and social service dollars are excluded.

Second Thoughts On Development Incentives

One of the constitutional amendments adopted by the **Louisiana** legislature as it recently finished its session as a constitutional convention is designed to end the practice of automatically granting local tax abatements for corporate facilities financed with tax-exempt bonds. Repeal of **Nebraska**'s corporate tax incentives, adopted in 1987, may not occur, but there is concern among legislators. A new study finds that the incentives for job development have cost considerably more than expected when the legislation passed. A recent Business Week (9/21) article ("States Now Want A Money-Back Guarantee") concludes, "Even in hotly contested deals, states are showing more savvy." It cites increasing use of *clawbacks* (provisions requiring return of subsidies if plants don't remain open), cost-benefit analysis of development incentives, and provisions in development deals tying state incentives to actual company performance such as the number of jobs created.

Bearing an economic development moniker hasn't been a guarantee that state programs won't be cut in austere periods. Some states have cut funding of their development agencies substantially, including eliminating some of their foreign offices and freezing or cutting activities like technical assistance to industry. In **Illinois**, where economic and community development activities are combined in a single agency, the FY 1993 general fund appropriation of $27.6 million is down from $93 million in FY 1992. Agency officials are talking about working with local development groups so that the state becomes a "wholesaler" of development activities. Rather than complaining loudly about the reduced state role, the president of the Chicagoland Chamber of Commerce told the Chicago Tribune (7/7) that the development appeared to be a natural one:

> *The economic times tend to drive these things. In the 1980s there was a lot of prosperity and people were prepared to spend. On Diamond-Star (the Diamond-Star Motors auto plant at Normal) they spent somewhere around $80,000 per job between the tax breaks and tax increment financing and enterprise zones. But in recession, government has to rethink, and you have to go back to the basic service you're supposed to provide, like public safety, health, and education.*

Wisconsin v. Illinois: Within two months of the Illinois action, the Milwaukee Journal (8/23) reported under the headline "Aid Cuts In Illinois Give State An Opening:"

> *The competition for business development between Wisconsin and Illinois heats up today as Wisconsin takes advantage of budget cuts in Illinois' business aid programs to launch a campaign to attract Chicago-area businesses to relocate or expand north of the border...*
>
> *Robert Trunzo, secretary of the {Wisconsin} Development Department said: "We think Illinois' situation presents an exciting marketing opportunity for us."*

PROTECTED PROGRAMS

There is increasing recognition that being an unprotected program in tight budget times results in budget cuts when practically all other programs are protected against the budget ax. This was recognized in the **Louisiana** constitutional convention and at an October rally at the state capitol when college students evidenced their support for the resulting amendment. It gives the legislature more power to cut programs, including school aid which enjoys constitutional protection in Louisiana.

The degrees of protection are quite different among different programs and perceived differently in various states based on in-state factors such as state court decisions and state constitutional provisions.

- **Binding Contracts** protect debt service appropriations, long-term lease payments in some states, and sometimes multi-year agreements such as employees' pay. Pension *payments to beneficiaries* and some other commitments (e.g., retiree health care) are considered contractual in some states, but state *contributions to pension plans* aren't.

- **Federal Constitutional Law** puts a floor under some state activities often including the conditions in state correctional and mental health institutions. Some programs are effectively mandated. For example, states can avoid paying for criminal defense lawyer costs for poor people only by refraining from prosecuting poor people.

- **Federal Statutes** constrain AFDC and Medicaid in many ways. For example, benefits cannot be cut without following certain procedural rules; states must provide a list of basic Medicaid services to have a Medicaid program; states cannot provide services to some without providing them to others, etc.

State actions under the control of the current legislature and governor are also constrained by state constitutions and interpretations of constitutional mandates by state supreme courts. Some of the most significant constraints are: (1) school equalization cases which don't technically affect total spending but which always do in practice, (2) criminal and inmate rights found in state constitutions by state courts though not found in similar or identical language in the federal constitution by federal courts, and (3) interpretations of constitutions and statutes appearing to create rights to have certain state services delivered.

When these constraints are summed, they significantly restrict the flexibility of state officials in dealing with new budgets. A common calculation is to add up all of these commitments or mandated programs as a percentage of the state's budget. The governors of **California** and **Texas** are fond of this calculation, using numbers over 75%. When revenue growth is slow, another approach is to calculate the percentage of growth required to cover unavoidable spending growth. This number can be over 100% under some circumstances.

Another way to use this information is to assess the situation of any program not protected by judicial decree, federal or state constitutional requirements, binding contracts, and federal mandates. In speeches before higher education groups, **Reports** editor Hal Hovey has been shocking audiences with the line that the path to survival in tight state budget periods is to have one or more of these. He suggests that higher education is about the only activity that isn't protected by one or more of them, thereby explaining why higher education has fared so badly in state budget competition.

The problems in defending higher education appropriations in current state fiscal situations goes beyond legal commitments to other programs. An example is **Kentucky** where university students rallied at the capitol in mid-October against possible mid-year budget cuts. Several years ago, the state raised taxes primarily to fund an extensive school reform and school finance equalization effort. The resulting school plan was adopted as a multi-year effort with constantly escalating costs. As recession depressed revenues and as other spending (particularly Medicaid and corrections) experienced substantial increases, higher education has been squeezed. Before any mid-year adjustments, the state higher education appropriation is about 2% lower than for FY 1992. While made in response to a court equalization decision, the legislature could back off elementary and secondary funding increases, but would then simply increase the criticism that much of the tax increase has been diverted from school quality improvement.

POVERTY

The Census Bureau recently released new data on median incomes and the percentage of persons in poverty in each state.

Because of the small samples involved, particularly for less populous states, the Bureau cautions: "Data users are advised strongly against using these estimates to rank states because different samples easily could lead to different median income and poverty rate estimates and rankings." Notwithstanding this warning, rankings from official data with caveats are clearly more useful than mere speculation, so the rankings are presented in the table below.

The caveats are quantified as "standard errors" in the Census report. They suggest that for the average-sized state of five million, the percentages shown could plausibly vary by about 0.6%, so Indiana's rate of 14.1% could be 14.7 or 13.5 and smaller states could vary more. This suggests caution in attaching much significance to narrow differences among nearly even states. Acknowledging this caveat, it is clear from the data that poverty rates do show significant differences among states.

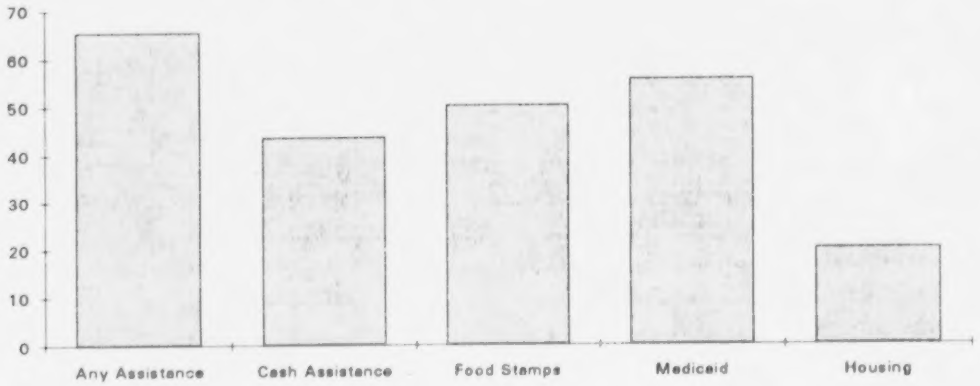
Percentage Of Persons In Poverty, 1989-1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	5.8%	18	Nebraska	10.9%	34	Indiana	14.1%
2	New Hampshire	7.1	19	Kansas	11.1	35	New York	14.1
3	Delaware	8.1	20	Alaska	11.2	36	Arizona	14.2
4	Rhode Island	8.2	21	Oregon	11.3	37	California	14.2
5	New Jersey	9.0	22	Ohio	11.8	38	Montana	15.8
6	Wisconsin	9.2	23	Minnesota	12.0	39	Oklahoma	15.8
7	Maryland	9.3	24	Colorado	12.1	40	Georgia	16.0
8	Washington	9.3	25	Maine	12.5	41	South Carolina	16.5
9	Utah	9.8	26	North Carolina	13.2	42	Texas	16.8
10	Hawaii	10.0	27	Illinois	13.3	43	Tennessee	16.9
11	Iowa	10.1		**United States**	**13.5**	44	West Virginia	17.2
12	Massachusetts	10.2	28	North Dakota	13.5	45	Kentucky	17.4
13	Vermont	10.5	29	South Dakota	13.5	46	Arkansas	18.4
14	Virginia	10.6	30	Missouri	13.6	47	Alabama	19.0
15	Wyoming	10.6	31	Idaho	13.7	48	New Mexico	20.9
16	Nevada	10.7	32	Michigan	13.9	49	Louisiana	22.0
17	Pennsylvania	10.8	33	Florida	14.1	50	Mississippi	23.8

The states of the Old Confederacy have had the highest poverty rates since statistics began to be kept. High poverty rates are also found in states that have had substantial in-migration from Mexico and the Caribbean area. The key to having low poverty rates is to have the suburbs from a major metropolitan area, like Boston or New York, while having the central city of that area located in another state. In comparing states, it should be remembered that the standard of poverty-level income is uniform nationally and relates only to income, not assets. A significant percentage of the rural poor are homeowners, while the urban poor generally rent. Some living costs are also lower in rural areas.

The official poverty figures don't reflect assistance provided to the poor through government means-tested programs. That assistance, excluding school lunches and certain other programs, reaches 65% of people in poverty with Food Stamps, cash assistance (welfare), Medicaid, and/or subsidized housing. The chart shows the percentage participating in each program. Cash assistance alone provides enough money so that 57.3% of persons in households where it is received are lifted above the poverty level by it.

Percentage Of Poor Receiving
Means-Tested Assistance, 1991



TAX INCREASES AND AUTOMATIC REVENUE GROWTH

Counting Tax Increases

The Presidential campaign has produced rival counts of how many times Governor Clinton and President Bush have raised taxes. The debate has shown that the numbers are tricky. For example, to get a large number for Bush one needs to count many different changes incorporated in one bill. To get 128 for Clinton (listed in the New York Times, 9/23, by Bush's campaign manager) it is necessary to include fees and some relatively small items like the 1991 decision to levy a fee of $1 per head on pigs sold at auctions. Applying a similar standard to the President and including tariffs produces a total of 178 increases (listed in the Times, 9/29).

Measuring Tax Burden Changes

A larger problem is that the burden of taxes is primarily set by the interaction of existing taxes and a state's economy, not by the changes in rates and tax base that count as tax cuts and increases. For example, large sums result from differences between states with graduated income taxes that index them for inflation, as **California** does, and states that don't, like **Minnesota**. There is much more natural growth in a tax system using a base of a graduated personal income tax, no sales tax, and property taxes on rapidly rising valuation, like **Oregon**, than one without an income tax and with heavy reliance on declining production of oil and gas, like **Texas**. An extreme illustration is the contrast between gasoline taxes and personal income taxes.

With unchanged rates, or even small increases, the gasoline tax burdens in relation to personal income will tend to drop as cars improve their gas mileage and as personal income rises with inflation but per gallon gasoline taxes don't. Conversely, with unchanged rates or even small cuts, a personal income tax with fixed (unindexed) brackets and personal exemptions and deductions will take an increasing share of personal income.

So looking at increases in rates alone won't work. What does work is looking at all state and local taxes together and relating their revenue to total personal income. Steven Gold recently did this calculation to compare levels in FY 1979 to those in FY 1990. The results appear in the table.

Percentage Change State And Local Tax Burdens, FY 1979-FY 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Massachusetts	-22.8%	18	Wisconsin	-2.2%	34	Hawaii	3.6%
2	Delaware	-10.0	19	Michigan	-2.1	35	New Mexico	3.6
3	New Hampshire	-9.7	20	Alabama	-1.6	36	Oregon	4.5
4	Rhode Island	-9.4	21	Kentucky	-1.3	37	Florida	4.6
5	Alaska	-7.9	22	Wyoming	-1.3	38	Arkansas	4.7
6	New Jersey	-7.0	23	Virginia	-1.1	39	West Virginia	4.7
7	Colorado	-6.1	24	Missouri	-0.4	40	Idaho	4.8
8	Pennsylvania	-5.9	25	Kansas	-0.2	41	North Carolina	4.8
9	Vermont	-5.9	26	Louisiana	0.1	42	Oklahoma	6.1
10	Maryland	-5.8	27	New York	0.3	43	Georgia	6.4
11	South Dakota	-5.0		**United States**	**0.7**	44	South Carolina	6.9
12	Arizona	-4.6	28	Illinois	1.8	45	Washington	7.7
13	Tennessee	-3.7	29	Maine	2.0	46	Iowa	7.8
14	Minnesota	-3.5	30	Montana	2.2	47	Indiana	8.0
15	Mississippi	-3.5	31	Connecticut	2.4	48	North Dakota	10.6
16	Nevada	-3.4	32	California	2.6	49	Texas	13.6
17	Nebraska	-2.8	33	Utah	2.7	50	Ohio	15.8

The differences among most states aren't dramatic, nor is the minuscule change in the national average. There appears to be no common explanation for the states shown as having raised tax burdens the most. The states that reduced burdens — defined as taxes as a percent of personal income — generally did so by extraordinary gains in personal income rather than by tax reduction.

Recent Revenue Increases, Personal Income Taxes

The distinctions between legislated and non-legislated increases, as well as difficulties in estimating revenue quarter-by-quarter are illustrated by the table. It shows the percentage increase in state personal income tax revenues in the second quarter of this year compared to the second quarter of last year, according to statistics compiled by the Center for the Study of the States.

Percentage Change In State Personal Income Tax Revenue, Second Quarter 1991 and 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arizona	-22.6%	15	Georgia	2.2%	28	Kansas	7.1%
2	North Dakota	-10.4		**U.S. w/o change*** **	**2.6**	29	West Virginia	7.2
3	Kentucky	-8.1	16	Alabama	2.9	30	Montana	7.4
4	Michigan	-5.7	17	Ohio	3.2	31	New York	8.5
5	Oklahoma	-5.1	18	Utah	3.8	32	California*	9.0
6	Indiana	-4.9	19	Oregon	4.9		**United States**	9.2
7	Vermont*	-3.2	20	Iowa	5.0	33	South Carolina	9.2
8	Louisiana	-2.0	21	Mississippi	5.0	34	Arkansas	10.9
9	Maryland	-1.5	22	Minnesota*	5.3	35	North Carolina*	12.9
10	Massachusetts**	0.0	23	Maine*	5.6	36	Hawaii	16.0
11	Virginia	1.0	24	Delaware	5.7	37	New Mexico	22.5
12	Illinois	1.2	25	Nebraska	6.1	38	New Jersey*	22.9
13	Idaho	1.3	26	Wisconsin	6.7	39	Rhode Island*	39.9
14	Missouri	1.3	27	Colorado	6.8	40	Pennsylvania*	45.8

* Reflects legislated tax increase. ** Reflects legislated tax cut.

*** Change in revenues excluding increased rates and tax base.

If state personal income taxes tracked growth in personal income, they would have increased by about 4.6%. However, much of the personal income growth during the period covered was in transfer payments like welfare and Social Security that aren't taxed, so wage and salary growth of 3.4% might be a better benchmark. But most state income tax revenues grow faster than personal income because of graduated rates and the impact of fixed dollar exemptions and deductions. So a plausible range for natural personal income tax growth would be bounded by 3% or so on the low side and 9% on the high side. The increase in income tax revenues from withholding, 7.6% from the 30 states from which Gold had data, is well within this range.

Many of the state results shown in the table fall outside this range. Several factors cause the deviation. First, some states significantly changed tax rates and/or tax bases as indicated (* and **) on the table. Second, many states collected more tax on CY 1991 income from withholding and estimated payments than taxpayers owed, particularly taxpayers unemployed for part of the year. Those taxpayers got refunds, many during the second quarter, creating negative tax yields and offsetting growth from withholding. Third, many states have tinkered with due dates for taxes and timing of refunds either this spring or last spring, distorting the year-to-year comparisons. Fourth, quarter-by-quarter comparisons are inherently difficult because slight differences in timing of payments and processing by state agencies can cause massive changes in the percentage increase figures.

Recent Revenue Increases, All State Taxes

The table shows the Center's compilation of quarter-over-quarter increases in total revenues. This pattern is much less erratic than income taxes shown in the table above. Most of the double-digit increases are the result of tax increases (*) or special factors such as the addition of revenues in Florida that previously went to a special infrastructure fund. The decrease in Arizona is partly explained by 1991 spring returns that were abnormally inflated because of underwithholding of income taxes during 1990 and thus larger payments in April of 1991 and a decline to more normal payments and refunds in April of 1992.

Percentage Change In Total State Tax Revenue, Second Quarter 1991 and 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arizona	-10.5%	18	Wyoming	4.6%	36	Montana	8.4%
2	Maryland	-2.8	19	Idaho	4.7		**United States**	**8.9**
3	Louisiana	-1.7	20	Oregon	4.8	37	Maine*	9.3
4	Massachusetts**	-0.4	21	Vermont*	4.9	38	Delaware	9.9
5	Oklahoma	-0.1	22	Mississippi	5.1	39	New York	10.7
5	Missouri	0.4	23	Colorado	5.7	40	Nevada	11.5
7	Pennsylvania*	0.7	24	Hawaii	5.9	41	North Dakota	12.0
8	Virginia	1.0	25	South Dakota	5.9	42	California*	12.6
9	Kentucky	1.3	26	Nebraska	6.0	43	Arkansas*	14.1
10	Ohio	1.9	27	Washington	6.0	44	Florida	14.2
11	Michigan	2.3	28	Illinois	6.1	45	New Mexico	15.9
	U.S. w/o change	**2.6**	29	Wisconsin	6.1	46	North Carolina*	19.7
12	South Carolina	2.7	30	Tennessee*	6.3	47	Connecticut*	26.2
13	Iowa	3.5	31	New Jersey*	6.5	48	Rhode Island*	32.0
14	Indiana	3.7	32	New Hampshire	6.8	49	Texas*	40.1
15	West Virginia	3.8	33	Minnesota*	7.5	50	Alaska	n.a.
16	Georgia	4.1	34	Alabama	7.9			
17	Kansas	4.2	35	Utah	8.1			

* Reflects legislated tax increase. ** Reflects legislated tax cut.

Even with these explanations, it would have been difficult for state estimates to predict the results shown in the table based upon economic forecasting tools alone.

Improving Revenue Forecasting

Practically all states base their revenue forecasts on economic models, statistical depictions presumably reflective of what causes changes in national and state economies. But the accuracy of these models, never a sure thing, is the subject of increasing doubt. In mid-October, Alan Greenspan, the chairman of the Federal Reserve who made a private career in economic forecasting, told the press: "No models can explain the types of patterns we are having. This is really a quite extraordinarily difficult type of environment."

State estimators are, as usual, being criticized heavily in the states where fiscal plans are being disrupted by abrupt changes in estimates. For example, **Maryland** substantially revised state and local finances this year with new state and local option taxes, but then had to consider cutbacks to reflect lowered revenue expectations. A major county executive summarized the concerns of many state and local officials:

> *We are now 22 days into the new fiscal year after taxes have been adopted and {we are} talking about massive cuts. One of the major areas that simply must be revised is the entire revenue-estimate approach.*

The long-time state comptroller, who makes the estimates, responded: "These are the most unusual times I've seen in state government in my time."

At the NCSL meeting this summer, the Council of State Governments presented the results of a survey of state revenue estimating practices. The survey covered what agency does the estimates, what outside forecasting groups and other state offices are involved, and what techniques are used. The Council concluded that states are moving toward more sophisticated forecasting techniques, consensus procedures involving legislative and executive branch estimators, and use of long-range forecasts. But the report is silent on two topics: (1) whether the accuracy of revenue estimates has been improved as a result of the changes and (2) what changes or practices are appropriate for adoption by all states.

Commenting on the study, **Reports** editor Hal Hovey counseled legislators on techniques for dealing with estimators, such as requiring them to specify their assumptions, trace their errors, and relate the assumptions used for forecasting revenue to those used to forecast spending. However, he said there was no evidence that any state had found a clearly superior way to estimate revenues. He recommended that state officials recognize that revenue estimating error is inevitable and hedge against errors by such devices as rainy day funds, leaving some spending contingent on revenue availability, and avoiding turning one year's unexpected revenues into the next year's permanent level of operating costs.

The Revenue Outlook

At their September meeting, the National Association of Business Economists released a poll of 49 forecasters who predicted that gross domestic product would increase by 1.8% in 1992, down from 2% predicted in May. These forecasters have also revised their estimate for 1993 from 2.7% to 3%. The Blue Chip Indicators consensus estimate also dropped to 1.8%, down from 2.1% estimated in July. These forecast revisions are likely to be tracked closely by revisions in state revenue estimates. This would imply that most states will see downward revisions of the economic forecasts underlying their FY 1993 budgets.

Expectations Of Tax Increases

The public believes that tax increases are likely, regardless of what is being said in campaigns. At the state level, the closest parallel to the campaigns of 1992 is the campaigns of 1982. At both times, state budgets were in poor shape because of recession. At both times, many states avoided decisive action to cut spending or raise taxes before the election. In both cases, candidates for the legislature and governor made no-new-tax pledges or came close to doing so. In December of 1982, special sessions raised state taxes in five states. Many of the states with gubernatorial elections in 1982 raised taxes in 1983.

There are no polls on the expectations for state tax increases, but polls on national policy may be a proxy. In a recent Harris Poll (Business Week, 10/19), from 60% to 70% of voters think their taxes will go up regardless of who is elected president. While the candidates are taking positions ranging from stressing opposition to higher taxes (President Bush) to promising higher taxes (Ross Perot), there is little difference in the public's perception of the likelihood of tax increases if different candidates are elected: 67% if Perot is elected, 64% if Clinton is elected, and 61% if Bush is elected. The same poll shows, as most polls do, less resistance to taxes on high income individuals and on alcoholic beverages and tobacco than to a national sales tax, higher federal income taxes, or higher gasoline taxes, which received the fewest favorable mentions by those polled.

MISCELLANY

Budget Cutting And The Courts

Tight budgets are producing many examples of litigation preventing or delaying cuts. In **New Jersey**, layoffs were delayed by an injunction. While the injunction was lifted, the issue is still in court. In **California**, the courts ordered the state to continue to pay Medicaid bills even though there was no valid state appropriation out of which to pay them.

A **Michigan** case typifies similar situations in many states. The closing of the Lafayette Clinic, a mental health facility, is controversial. The governor wants it closed for patient care, continuing only with some research functions. Enough legislators want it open so they appropriated funds in the FY 1993 budget for its operation. The governor vetoed the appropriation and the legislature didn't override. So at the beginning of Michigan's October 1 fiscal year there was no appropriation. On October 1, a state lower court judge ordered that the facility remain open and ordered the mental health commissioner jailed for contempt of court if he failed to continue to operate it for the 39 remaining patients, presumably using all the 250 remaining staff members. The governor wasn't happy:

> *Judge Hathaway is far out of bounds. It was very poor judgment, a very political judgment and unjudicious behavior.*

There may never be a clean legal resolution of this case, and others like it in other states, because of compromises in both the legal and political processes. When Michigan appealed the case, it agreed to keep the facility going with FY 1992 money while it lasted. The appeals court overturned the order for incarceration of the mental health director. The Senate passed legislation restoring a small appropriation for research operations, but rejected another appropriation for operations by votes of 16-19 and 18-19.

California's Problems

In an October hearing before a **California** Senate Committee, fiscal expert Steven Gold addressed what differentiates the state's fiscal circumstances from the other 49 states. His points, similar to the analysis in Issue 18, lay California's problems on three doorsteps:

- Demographics, particularly a 3.5% annual increase in school enrollment compared with 1.5% nationally.
- Economics, growth outdistanced by sub-par national performance.
- Fiscal Policy, particularly restraint in increasing taxes in the 1980s and limit measures (e.g., Proposition 13 affecting property taxes and the Gann Amendment affecting state taxes).

Gold disputed Governor Wilson's assertion that California has a "Cadillac system of government services." Gold finds pupil teacher ratios second highest in the nation, below-average college tuition and above-average welfare payments before, but not after, adjustments for cost of living differences. He also finds California to be one of the most generous Medicaid spenders, but doubts that the state should cut its services. Higher public sector salaries increase California costs, but Gold asserts that the test is the relationship between private and public salaries in California, not comparing California public salaries to those in other states.

Gold told committee members that Proposition 165's cuts in AFDC benefits differed from the emphasis in other states on welfare cuts affecting 100% state and local general assistance programs. He suggested that the state adopt "more positive, humane approaches to California's fiscal problems than an assault on poor children." He argues that AFDC isn't the main cause of California problems, that cost of living differences mean AFDC benefits aren't as generous as they appear, and that increases in AFDC caseloads are caused by recession and "once it ends, AFDC rolls will tend to decrease."

Brian Roherty, the executive director of the National Association of State Budget Officers, suggests in NASBO News (Sept.) that Californians are "not alone out there anymore." He emphasizes problems common to California and other states — need for dealing with federal issues ("a fiscal tidal wave heading for the states during 1993") and looking for "multiple and hard fought solutions rather than an old fashioned miracle."

Charter Schools

Governor Florio extended the debate over "charter schools" to **New Jersey** with a recent proposal that a maximum of two such schools be permitted in each of the state's 21 counties. Charter schools are already authorized under **Minnesota** law, with one school already in operation and three more, out of a maximum of eight authorized, scheduled to open next year. Under **California**'s plan, up to 100 such schools may be established. The concept, inherently vague at the outset, is to allow individual schools to escape the bureaucracy associated with school districts by, in effect, receiving a separate charter from the state giving them the flexibility associated with private schools. National Education Association affiliates have opposed the concept, saying it diverts attention from improving all schools.

Earmarking Tobacco Taxes

Health-oriented groups are pushing proposals for large increases in the cigarette tax (typically 25 cents a pack) with new revenues earmarked for anti-smoking programs and health spending arguably related to smoking. Such a measure was adopted by initiative in **California** and is on the November ballot in **Massachusetts**, where opponents have raised at least $6 million to try to defeat it.

As proponents concede, the measures incorporate two apparently inconsistent objectives. On the one hand, a major rationale for the tax increase is to discourage smoking. If successful, this would mean reducing state general revenues from existing cigarette tax rates as well as cutting the potential revenue for new health programs. On the other hand, the increases are supposed to pay for whatever increases in health spending they are designed to finance.

This fall, Governor Casey called the **Pennsylvania** legislature into special session to adopt a plan for youth health care to be funded from two cents of the cigarette tax that is already being collected. Versions of the plan are encountering two concerns in the legislature: (1) making available a 100% state-funded program that may draw some clients otherwise eligible for Medicaid with federal cost sharing, and (2) committing the state to providing health care to about 100,000 children. The fear is that the cost of the commitment will escalate while the yield of the tax will drop.

Economic Performance of the States

Comparing Individual States: Indicators of state economic performance continue to show many smaller Western states outperforming the nation by wide margins while Northeastern states and California have the most serious economic problems. The table shows the states that deviated more than 1.5% from the national one-year employment change.

Growth In Non-Agricultural Employment, July 1991 to July 1992

Rank	State	Percent	Rank	State	Percent
1	Idaho	3.4%	43	California	-2.1%
2	South Dakota	2.6	44	New Hampshire	-2.9
3	Arkansas	2.5	45	Maryland	-2.9
4	Utah	2.5	46	New Jersey	-3.1
5	North Dakota	2.1	47	New York	-3.2
5	Nevada	2.0	48	Massachusetts	-3.2
6	Montana	2.0	49	Connecticut	-3.8
	United States	**-0.5**	50	Rhode Island	-3.8

Retail trade growth shown by comparing the first seven months of this year with the first seven last year shows similar regional patterns. The strongest sales growth appeared in the states not bordering Oceans. Among what are called geographic divisions, the winners were the West and East South Central areas, together extending from Texas east and north to Kentucky and Alabama, with sales growth over 11%. Lagging the U.S. average of 4.7% growth: New England (1.2%), East North Central (1.9% for Wisconsin, Michigan and the three industrial states on their Southern borders), Pacific (2.3% in the region dominated by California), and South Atlantic (3.6% for Delaware south through Florida).

Building permits issued through July increased 16% over the same period last year. The largest gains were in resource-oriented states — over 40% in **Colorado**, **Idaho**, **Louisiana**, **Montana**, **Utah**, and **Wyoming**. Only three states showed significant drops in this indicator: **California** (-11%), **Nevada** (-20%), and **Hawaii** (-30%).

National Economy Sluggish: While some states are doing significantly better than others, no state is doing as well as many states did in past recoveries from recession. In its Pocket Chartroom (Sept./Oct./92), Goldman Sachs tabulated the growth in gross domestic product in the current recovery period and the five previous ones. From the second quarter of 1991 to the second quarter of 1992, growth was under 4%. In the five earlier recoveries, going back to the early 1960s, every first year of recovery saw 11% or better growth.

Federal Debt And State Budgets

In NASBO News (Sept.), the executive director of the National Association of State Budget Officers compares the current federal deficit (using $400 billion) with the smaller total of state general fund budgets (using $300 billion). In a recent state forum, Tom Triplett (Minnesota Business Partnership) followed the same approach for an individual state. He applied Minnesota's 2% share of national totals (e.g., population, gross state product) to calculate its share of the deficit. He then compared that share with the state's spending. Calculating state shares of the federal deficit yields the big numbers shown in the table, which can be contrasted with whatever state numbers readers consider appropriate (see Technical Notes for methodology).

Annual State Share Of Federal Deficit With Current Federal Spending And Taxes
($ millions)

State	Amount	State	Amount	State	Amount
California	$39,584	Tennessee	$6,454	Utah	$2,306
New York	23,529	Maryland	6,332	Nebraska	2,076
Texas	22,605	Minnesota	5,775	New Mexico	2,017
Florida	17,299	Louisiana	5,540	Nevada	1,673
Pennsylvania	15,585	Alabama	5,328	Maine	1,609
Illinois	15,040	Arizona	4,886	Hawaii	1,479
Ohio	14,253	Kentucky	4,838	New Hampshire	1,440
Michigan	12,206	South Carolina	4,639	Idaho	1,354
New Jersey	10,111	Colorado	4,400	Rhode Island	1,308
North Carolina	8,778	Connecticut	4,288	Montana	1,0[illegible]3
Georgia	8,629	Oklahoma	4,137	South Dakota	916
Virginia	8,190	Oregon	3,807	Delaware	886
Massachusetts	7,812	Iowa	3,642	North Dakota	827
Indiana	7,310	Mississippi	3,377	Alaska	743
Missouri	6,721	Kansas	3,251	Vermont	739
Washington	6,538	Arkansas	3,091	Wyoming	599
Wisconsin	6,456	West Virginia	2,347		

Because states were assumed to share in the federal deficit in proportion to population, the relative position of the states in the table simply replicates their relative populations.

Health Care Financing

Health Cost Overruns Continue: The pace of health care financing problems, described in detail in Issue 19, continues. Cost overruns in **Medicaid** are common, although few have yet reached public and legislative attention. The development of alternatives for cutbacks to stay within current appropriations is a public process in **Arkansas** and **Nebraska**, where the topic is one subject of a special legislative session. Departing Governor Gardner has **Washington** staff members working on cutback alternatives including dropping optional services, cutting back the program for the Medically indigent, and reducing state health care (but not Medicaid) costs by shifting some 100% state-funded activities to Medicaid.

New Universal Care Plan Proposed: The most dramatic recent proposal for near-universal health care was recently made by **Kentucky**'s governor. Prospects are uncertain in a legislature concerned over the program's cost and potential effects on economic development. Faced with these problems, the governor dropped his idea of a special session this year. Instead, an actuary will review cost estimates and the governor will seek consideration of his plan by the legislature next year.

New Plan For Children's Health Debated: In an October special session, **Pennsylvania** legislators are working on a non-Medicaid children's' health program using proceeds from two cents of the cigarette tax. The governor's original plan was oriented to children under six, but has been modified in discussions with legislators to target children under 20 in families with moderate and low incomes. The plan would extend to families at 300% of the poverty level (about $42,000 for a family of four), but the families themselves would pay a large share of the costs.

While considering the governor's plan, many Keystone State legislators are seeking to use the state's procedures for review of administrative rule making to block cutbacks in Medicaid coverage for general assistance recipients. The cuts underlie the appropriations level adopted in the legislative session earlier this year.

Provider Taxes: The states have been adopting health care provider taxes quietly — convincing the media that adjustments in past donation programs and compliance with federal guidelines, not new taxes, are the issue. With providers cooperating in return for higher reimbursement rates, the taxes have gone largely unnoticed.

This wasn't an option in **Oklahoma** because of a state requirement that tax increases be submitted to the voters. So the $90 million in taxes on hospitals, nursing homes, and drugs is on the November ballot. Some health care providers, particularly those who don't receive substantial Medicaid funds, are fighting the tax. The Department of Human Services has already announced cutbacks that would take place if the tax is not approved.

Taxing Wages Of Casual Workers

State income taxes and similar municipal taxes in Cleveland, New York, and Philadelphia are clearly applicable to income earned in a jurisdiction by non-residents. This means that consultants, professional athletes, entertainers, and traveling construction workers have tax liability to many jurisdictions.

Generally, the tax liability of the individual involved is little affected by the issue. For example, professional football players are likely to be paying tax on their entire incomes. Putting part of the tax where they play away games would reduce tax liability in the home state, but the home state would recover by taxing visiting teams. Because state and local taxes in one jurisdiction are generally creditable against taxes in others, many of the differentials in tax rates would also be washed out.

Individual jurisdictions aren't always indifferent to the adjustments as indicated by recent efforts by Philadelphia to collect its wage taxes from day nurses, lawyers, and athletes whose professions may bring them to the city for limited periods of employment. Philadelphia, as part of its efforts to reduce persistent fiscal problems, has recently initiated collection efforts against over 6,000 lawyers, accountants, and athletes.

Workers' Compensation

The **Pennsylvania** legislature went into special session in October to deal with Workers' Compensation reform as well as health care for children. The basic WC issues are the same as in other states. They are particularly salient in Pennsylvania because the proposed rate increase, 52%, is higher than elsewhere. The business-backed legislation seeks to control benefit amounts and limit eligibility. The governor has said he would veto it. His proposal is to limit medical costs by capping doctors' fees and to increase competition among insurance providers.

The state has a unique system because the Pennsylvania Manufacturers' Association is itself one of the insurers. The head of the state AFL-CIO calls a system where manufacturers are both the sellers and buyers of WC coverage "all smoke and mirrors."

Ironically, while **Pennsylvania** legislators were considering changing the employer-managed system as a reform, **Maine** legislators, also in special session, were considering setting up an employers' mutual insurance company as a reform.

In early October, legislators in **Maine** reached agreement on their Workers' Compensation reform plan. The plan is expected to save employers from 12% to 14% in premiums, primarily by substantial benefit reductions including a drop in the maximum weekly benefit from $536 to $441 and reducing the duration of permanent partial disability benefits from ten years to five. Under pressure of threatened withdrawal of private insurers from the state, the legislature adopted a new administrative apparatus for WC and authorized an employers' mutual company to provide competition to the private carriers.

There are roughly similar issues in **California**, where Governor Wilson recently vetoed several WC measures and announced his own proposals. They are designed to cut employer costs by eliminating certain benefits (e.g., stress claims), seeking to cap medical costs by managed care, and avoiding the immediate benefit increases found in the measures adopted by the legislature. Majority leaders (D) in the legislature have objected to the governor's call of an October special session on the grounds that they have already acted on WC reform.

TECHNICAL NOTES

Competing For Jobs: The Inc. 500 companies, which appear in the magazine's October issue, are related to 1991 population estimates in the table.

States And The International Economy: For more information see State And Local Governments In The International Arena (Advisory Commission on Intergovernmental Relations, Washington, DC 20575), States In The International Arena (special issue of The Journal Of State Government, Council of State Governments, Iron Works Pike, P.O. Box 11910, Lexington, KY 40578), and Competition Across The Atlantic: The States Face EC '92, (National Conference of State Legislatures, 1560 Broadway, Denver, CO 80202).

Poverty: Three recent Census Bureau reports provide considerable detail on the characteristics of the poverty population and the impact of government assistance on their living levels: Poverty In The United States: 1991, Measuring The Effect Of Benefits And Taxes On Income And Poverty: 1979 to 1991, and Money Income Of Households, Families, and Persons In the United States: 1991. None of these reports contains details of poverty populations in each state.

Tax Increases And Automatic Revenue Growth: Gold's calculations appear in the New York Times (10/4 with a correction for Ohio on 10/11). The start year, 1979, was chosen as Governor Clinton's first year. The end year, 1990, is the last year with Census data available. The FY 1990 burdens and state rankings are Table D-1 in States In Profile. The tax burden computation excludes other sources of revenue such as federal aid, fees, and interest earnings. Gold expresses changes as a percentage of a percentage. For example, the Texas burden grew from 9.43% of income to 10.71% of income. The burden grew by 1.28% of income (not shown) or by 13.6% (12.24 times 100 divided by 11.92).

The statistics on growth in personal income and total tax revenues come from State Revenue Reports (August, Center for the Study of the States, Rockefeller Institute of Government, 411 State St., Albany, NY 12203).

Federal Debt: The calculation uses 1991 population estimates of the Census Bureau which total 251,583 for the 50 states. Purists can add the District of Columbia, territories and possessions in any combination they think appropriate. The calculation uses the federal deficit being incurred in the second quarter of 1992 expressed at an annual rate, or $327.8 annually. The federal budget concept is that of the national income accounts. Using other concepts (e.g., federal budget basis, with or without certain transactions such as bank bailouts) or other time periods will produce somewhat different numbers for deficits. Readers can adjust the table for their concept of what the federal deficit is by multiplication by a fraction with their deficit the numerator and $327.8 as the denominator.

The per capita federal *deficit* calculated by the method above is $1,303. With the deficit running at nearly $1 billion per day, the federal *debt* is a rapidly changing number. There are different concepts of debt (e.g., including or excluding debt not held by the public such as debt held by trust funds). Multiplying the deficit numbers by 10 to get debt is a reasonable approximation, making the debt about $13,000 per capita. On October 1, federal debt held by the public was about $3.0 trillion and total federal debt was about $4.5 trillion.

Health Care Financing: The discussion of health care financing is taking place in an atmosphere of increasing uncertainty about federal regulations affecting provider taxes which may be issued after the November elections and about further litigation over whether existing state indigent care programs are preempted by federal (ERISA) legislation.

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